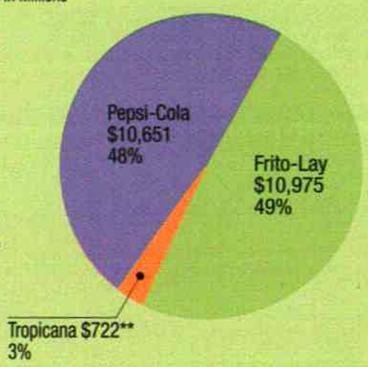
PepsiCo, Inc. Annual Report 1998

Getting our ducks in a row

Contents

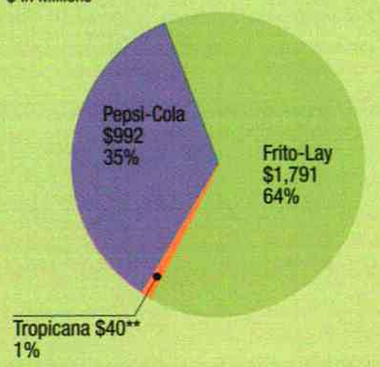
Financial Review

Net Sales
Total: $22,348
$ In Millions



** Includes only fourth quarter results.

Segment Operating Profit
Total: $2,823*
$ In Millions



* Excludes unallocated expenses.

Financial Highlights

PepsiCo, Inc. and Subsidiaries

(in millions except per share amounts; all per share amounts assume dilution)	December 26, 1998	December 27, 1997	Percent Change
Summary of Operations			
Net sales	**$22,348**	$20,917	**+7**
Reported			
Operating profit	**$ 2,584**	$ 2,662	**-3**
Income from continuing operations	**$ 1,993**	$ 1,491	**+34**
Per Share	**$ 1.31**	$ 0.95	**+38**
Other Data			
Net cash provided by operating activities	**$ 3,211**	$ 3,419	**-6**
Acquisitions and investments in unconsolidated affiliates	**$ 4,537**	$ 119	
Shares repurchased	**59.2**	69.0	
Return on invested capital (a)	**16%**	18%	

(a) Defined as income from continuing operations before after-tax interest expense, amortization of intangible assets, unusual items and the 1998 tax benefit divided by an average of the five most recent quarters net asset base before accumulated amortization of intangible assets and net asset base of discontinued operations.

Dear Friends:

Hope you like our web-footed friends. They're our way of saying we've been working long and hard to ready PepsiCo for a big, bright future.

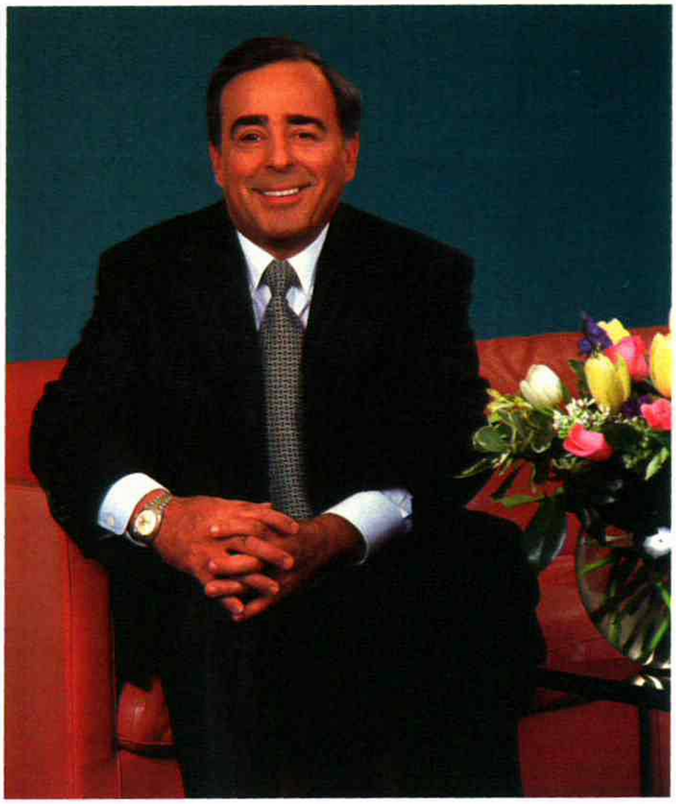
For nearly three years PepsiCo has been undergoing a major strategic transformation. And while 1998 certainly offered its share of challenges, I'm very pleased to report that our strategy is beginning to pay off:

- Consumers around the world bought more of our snacks and beverages than ever before.
- We gained market share in both snacks and beverages in the United States, our biggest market.
- Our international snack and beverage units both posted healthy volume growth, even amid economic turbulence.

We also acquired Tropicana Products, Inc., the world's most successful juice company, an exciting step that gives PepsiCo several more outstanding trademarks with lots of growth potential.

When the dust settled on 1998, we reported earnings per share of $1.31, up 38% from the year before. Operating profit was down slightly, as we made important strategic investments in advertising and marketing and strengthened our sales and distribution systems.

Even with our acquisition of Tropicana, our return on invested capital was about 16%, a marked improvement from our average in the three years preceding our reshaping of PepsiCo. And operating cash flow from our core packaged goods businesses surpassed $2 billion – for the second year in a row.



Roger A. Enrico
Chairman and Chief Executive Officer

Do we face tough challenges? No question about it. But we always have. And fortunately nothing I see on the horizon changes the positive outlook for PepsiCo or is cause to shift our strategic course. In fact the challenges we face in the marketplace highlight exactly why we've worked so hard to refocus this great corporation. These days you can succeed only if you concentrate on what you do best and use your resources to their greatest advantage.

Let me offer some background.

Several years ago we assessed our aspirations for PepsiCo. We wanted nothing less than for this company to enter the 21st century as a truly outstanding financial performer, one that can consistently produce healthy returns to shareholders, year in and year out. We knew PepsiCo had the strength to do it. But we also knew we had to leverage our powerful global brands and abundant cash flow more effectively.

Wayne Calloway 1935-1998

PepsiCo lost a great friend in 1998.

Wayne Calloway, retired chairman and chief executive, died in July after a long illness. Wayne was a gifted leader, an esteemed colleague and a man of singular grace and kindness.

In 29 years with PepsiCo, including 10 as CEO, he was wonderful to shareholders and all of us who had the privilege to work with him. His quiet intelligence, unwavering integrity and remarkable faith in people made him a truly extraordinary executive. He was also extremely dedicated – to PepsiCo, to his alma mater Wake Forest, to his community and especially to his family.

Wayne possessed many wonderful qualities. Yet what struck me most was that, for all his success, Wayne never lost his gentleness or warmth. Like so many of those who knew Wayne, I miss him greatly. And I know that feeling is shared by every PepsiCo employee and by thousands of others whose lives he touched.

Roger

A Strategy In Two Words: Focus and Investment

So we've pursued a strategy you could sum up in two words: *focus* and *investment*. You get your ducks in a row, then put some real money behind them.

Basically that means we're focused on consumer packaged goods businesses that play to our strengths – and we're out of businesses that others can do better. We successfully spun off our big restaurant brands and sold other businesses, ranging from a baby food company in Mexico to a candy company in Poland. We've teamed up with some strong bottling partners. We've also taken the critical step of separating the bottling and concentrate parts of our beverage business so both can operate more effectively.

Most important, we've invested billions of dollars in the heart and soul of our business: brands. We've been expanding distribution, creating innovative products and packages and adding powerful new brands to our portfolio.

The whole point is to make our businesses much stronger and more competitive for the long term – and able to weather economic storms and marketplace skirmishes with minimal disruption.

The beauty of the strategy is that it has generated billions of dollars in cash. That cash plus a big tax benefit we recorded in 1998 have enabled us to do two important things simultaneously: spend aggressively to reinvigorate sales momentum and deliver solid earnings per share growth. As that sales momentum continues, operating profit should follow – and I think you'll see signs of that in 1999.

So that's the big picture.

Of course, you might ask: Is it working?

I believe the answer is clearly yes.

PepsiCo is a very different company than it was a few years ago, with a much more solid foundation for consistent, long-term growth. And the best evidence is our improving volume. To me, that's the most fundamental measure of health in any consumer business.

But to give you a better sense of what I mean, let's look closer at each of our businesses.

Building a Stronger PepsiCo

1996

- Refranchised 655 restaurants
- Closed 379 underperforming restaurants
- Restructured Pepsi-Cola International
- Enlisted strong new bottler in Venezuela
- Created worldwide snack and beverage units
- Announced plan to sell non-core restaurant chains
- Repurchased 54 million shares

Pepsi-Cola Company

North America

Pepsi-Cola made a lot of news in 1998. Much of it was driven by one very important change in the marketplace. Over the last several years our biggest customers, grocery stores, have been merging, buying each other and otherwise combining at a very rapid rate. Today there are fewer chains than a couple of years ago, but they tend to be a lot bigger and spread over much larger regions.

That fundamentally changed the bottling business. Today size drives success. The bigger the better. Because that's how you achieve true economies of scale in manufacturing and distribution. Equally important, size enables a bottler to provide the service that large, geographically diverse retailers need – whether it's a single invoice or unified marketing support over a large area.

So we've been aggressively consolidating more of our bottling volume among a handful of large, well-capitalized "anchor bottlers" that are closely aligned with PepsiCo and focused solely on manufacturing, selling and distributing:

- We created a separate unit for our company-owned bottling operations, called The Pepsi Bottling Group (PBG), and plan to sell a majority interest to the public this year. With more than $7 billion in sales, PBG will account for more than half our North American volume. And as a public company it will have the size, financial resources and capital structure to be a truly superb bottler – and to advance consolidation by buying smaller bottlers.
- In January 1999 we reached an agreement with Whitman Corporation, the largest independent Pepsi bottler, to form a new, larger bottling company that would account for 17% of our U.S. volume. If Whitman shareholders approve, the new company would combine certain PepsiCo-owned bottling operations in the United States and Central Europe with most of Whitman's operations.

PepsiCo would get an equity stake ultimately approaching 40% and net proceeds of about $300 million.

The best part of our anchor bottler strategy is that it frees us to devote all of our management attention to marketing and brand building. And on that front we've made great strides.

In 1998 we gave our flagship Pepsi brand a much brighter, more prominent image. We placed more than 190,000 new vending machines and coolers (on top of 150,000 in 1997). We launched or expanded great new products – like Pepsi One, Aquafina and the Frappuccino coffee drink we created with Starbucks. And we supported our efforts with lots of advertising and marketing.

1997

- Spun off Pizza Hut, KFC and Taco Bell as Tricon
- Refranchised New Zealand restaurants via public offering
- Divested five non-core restaurant chains
- Divested PFS restaurant supply unit
- Received $5.5 billion in restaurant disengagement proceeds
- Divested Syrena candy business in Poland
- Divested Gerber baby food business in Mexico
- Placed more than 150,000 beverage coolers and vendors in the U.S.
- Enlisted new bottlers for territories in Brazil, Philippines, Japan and Scandinavia
- Renegotiated bottler contracts to centralize fountain beverage distribution
- Expanded U.S. fountain beverage sales and service group
- Acquired Pehuamar snack business in Argentina
- Divested Obregon flour mill in Mexico
- Repurchased 69 million shares

As a result, unit volume took off.

Pepsi-Cola North America volume grew 6% in 1998, our best rate in four years. And in the U.S. we posted our biggest market share gain in nine years. Volume of larger single-serve packages doubled over the past five years. And our U.S. fountain syrup business, which we began developing in earnest in 1997, showed lots of vitality as we expanded existing accounts and added new ones.

And thanks to Pepsi One, the first soft drink in the U.S. sweetened with a blend of aspartame and the newly approved Acesulfame K, we reinvigorated the low-calorie soft drink category, a testament to the power of innovation.

International

Even with sharp economic downturns in Russia and Asia, Pepsi-Cola International has continued to build on the momentum achieved since its 1996 restructuring.

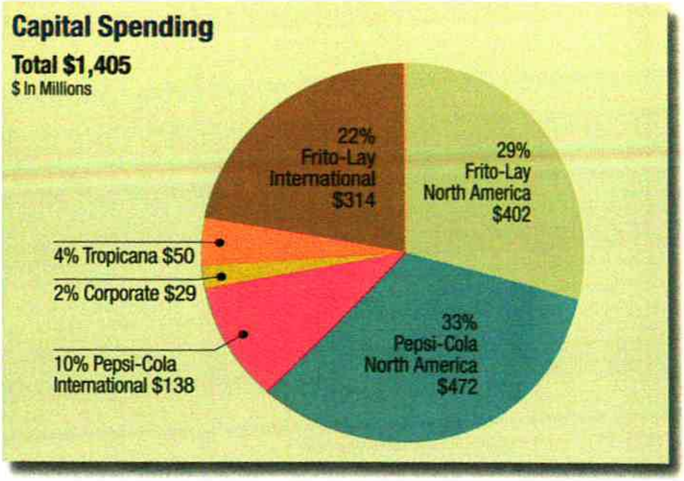
We have very consistently and deliberately pursued a strategy focused on enlisting strong bottling partners, improving our operational capability and building our core brands. In 1998 it really began to click.

International beverage volume grew 6%, our best rate in three years and about equal to our primary competitor.

1998

- Acquired Tropicana, world's largest branded juice company
- Announced public offering of The Pepsi Bottling Group
- Launched new blue globe logo for brand Pepsi
- Launched WOW! fat-free snacks nationally in the U.S.
- Launched Pepsi One, sweetened with Acesulfame K
- Acquired Smith's Snackfoods Company, Australia's market leader
- Acquired snack chip businesses in France, Holland, Belgium
- Divested BN biscuit business in France
- Entered joint venture to become snack chip leader in South and Central America
- Acquired Barcel, Chile's second-largest snack company
- Expanded stake in Tasty Foods Egypt
- Acquired bottling operations in four U.S. states and two Canadian provinces
- Placed 190,000 beverage coolers and vendors in the U.S.
- Acquired Cracker Jack snack brand
- Agreed to sell Polish chocolate and biscuit units
- Consolidated Pepsi and Frito-Lay U.S. media buying
- Repurchased 59 million shares

That performance capped six consecutive quarters of volume gains. Best of all, that volume growth came not from a handful of markets, but from across a broad geographic base. We posted healthy double-digit gains in many of the markets most crucial to our long-term success: big emerging markets like India and China as well as important established markets in Mexico, the Philippines, the Middle East and Latin America. For the first time in our history, we sold more Pepsi in international markets than in the United States.



Frito-Lay Company

North America

Strategic investments in big opportunities at Frito-Lay helped fuel volume growth of 5%, the fastest growth of any major U.S. food company. That raised our share of industry pound volume nearly two points to 56%, our highest ever.

One area of investment was launching and expanding new products. Our WOW! line of fat-free snacks was one of the most successful new food products ever. Doritos 3-Ds three-dimensional tortilla chips were so popular we couldn't produce them fast enough. And we successfully relaunched the much loved Cracker Jack brand that we acquired in early 1998.

New or underdeveloped distribution channels offer still greater opportunities. So we have been more aggressive in developing foodservice and vending accounts, an important source of growth in 1998. Today Frito-Lay products are available through more than a million vending machines.

With a U.S. market share approaching 60%, we have an extraordinary opportunity to really leverage our vast scale. We're doing exactly that. To reduce manufacturing costs, we're closing four of our oldest plants and expanding five of our newest and most productive. We're also strengthening logistics and distribution systems to improve efficiency and allow our 19,000 salespeople to devote more time to what counts most: selling.

These efforts, along with our continued focus on innovation and broader distribution, should result in both good volume growth and healthy operating profit at Frito-Lay.

International

Our international unit had very healthy volume momentum as we closed 1998, with snack chip volume up 14%, including acquisitions. Volume in our largest international unit, Sabritas in Mexico, grew even faster, about 15%.

Frito-Lay International represents one of our biggest opportunities for rapid growth on a large scale. Look at where we stand: We are the world's largest salty snack company. And while we have our share of local competitors, we face no major multinational competition. Not only that, relatively low per-capita snack consumption in many countries gives us tremendous room to grow.

To exploit that opportunity fully, we need to build greater scale. Today we have international operations in 40 countries, yet three of them – Mexico, the United Kingdom and Brazil – produce the lion's share of our sales and profit. In most of the others our operations have not been large enough to achieve true economies of scale and the profit margins that go with that. One of our strategic goals has been to enlarge those smaller operations, in part through acquisitions, so they can become more important profit contributors. Not only will that improve our profit overall, it will make us less dependent on a few key markets. That's important when your goal is consistency.

In Australia, for example, we acquired The Smith's Snackfoods Company, which moved us from number two to market leader. In South and Central America, a combination of acquisitions and a nine-country joint venture with Empresas Polar raised our region market share to over 50%. These kinds of investments dramatically improve our ability to build big, profitable businesses – and to produce strong, consistent financial results.

Tropicana Products

We began 1998 with no plans for a large-scale acquisition. Yet midway through the year we saw a chance to own Tropicana Products, the world's largest maker and marketer of branded juices.

It was a wonderful opportunity for PepsiCo, so we seized it.

Tropicana is an outstanding consumer packaged goods business, the leader in the fastest growing segment of the juice industry, not-from-concentrate juice. It expands our portfolio with four superb brands: Tropicana Pure Premium, Tropicana Season's Best, Tropicana Twister and Dole – all with lots of growth opportunities.

Tropicana extends our reach very significantly, especially to mornings and to people who may not consume carbonated soft drinks, including young children.

Its flagship brand, Tropicana Pure Premium, commands remarkable consumer loyalty and is by far the world's top-selling orange juice brand.

In fact, consumers around the globe drank more than $1.6 billion worth of Tropicana Pure Premium last year, and it still has plenty of room to grow. Just look at the United States. Only about one in five American breakfasts today includes orange juice. Increasing that even modestly could expand our volume dramatically. And there's even greater potential if we broaden distribution on a scale closer to our snacks and soft drinks.

In and of itself, Tropicana is a strong business with excellent prospects. For PepsiCo, however, it offers a special benefit. With a broader portfolio of strong brands, we'll better serve our retail customers – the supermarkets, convenience stores, restaurants and other outlets that sell our products to consumers.

The Power of One

Serving those retail customers effectively – and helping them grow – is about as crucial to our own success as anything we do. We work at it relentlessly, and it shows. In 1998 our products contributed more than any other packaged goods company to the sales growth of U.S. supermarkets, mass merchandisers and chain drugstores. We generated retail sales of more than $11 billion in these channels – over $800 million *more* than the year before.

Top Providers of Growth to Retailers

Sales Growth Provided to Supermarket, Chain Drug and Mass Merchandise Stores in 1998
$ In Millions

1. PepsiCo, Inc.	**$ 822**
2. Procter & Gamble	$ 569
3. Philip Morris Co., Inc.	$ 464

Still, we think we can do even more for our customers by taking greater advantage of the combined strength of our companies.

This year, for example, we conducted a national joint merchandising program, our biggest ever, involving Frito-Lay and Pepsi-Cola in more than 50% of the nation's supermarkets.

We're also aggressively exploring savings available by combining some of our back-office functions, like accounts payable, accounts receivable and information systems.

A New PepsiCo

By the end of 1999, with the completion of our transaction with Whitman Corporation and our public offering of The Pepsi Bottling Group, PepsiCo will have undergone a very significant transformation. We'll be a leaner, stronger company than a few years ago and much better equipped to achieve the consistent earnings growth to which we aspire:

- The majority of our sales and profits will come from snacks, where we are the market leader.
- Frito-Lay North America will have a more streamlined and efficient manufacturing system.
- Pepsi-Cola Company will be squarely focused on what we do best: building brands.
- Our bottling system will be stronger and better able to serve retailers.
- Our international snack business will have a broader geographic base.
- More than three-quarters of our sales and profits will come from healthy, stable economies like the United States, Canada and Europe.
- Our balance sheet will be stronger, as we reduce debt using proceeds expected from our bottling transactions.
- We'll be the leader in branded juices, a category that complements our other businesses.
- We'll achieve a return on capital substantially higher than when we began reshaping PepsiCo.
- We'll generate double-digit operating profit growth from continuing operations.
- We'll have the financial resources and flexibility to repurchase shares and make strategic investments.

Looking ahead, I think our prospects are excellent. Our industries remain very competitive, of course. But we're now much better able to compete. We've eliminated distractions, concentrated on what we do best and invested in what consumers really care about. At the same time we're taking greater advantage of our combined strength as a corporation.

In my view, PepsiCo is in the best shape it's been in years. Our ducks are in a row. And I think that we're in a great position to pursue the vast opportunities ahead of us.

Roger A. Enrico
Chairman of the Board and Chief Executive Officer

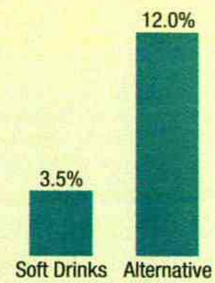
Pepsi-Cola

Lined Up for Growth

Pepsi-Cola is stronger today than it was just a year ago. We have big, powerful trademarks in large, attractive categories. We've made excellent progress across all distribution channels. We've taken some major steps to consolidate our bottling system. We've continued to strengthen our international business.

These changes will drive increased sales of our soft drinks as well as our ready-to-drink tea and coffee, bottled water and sports drinks. We'll introduce new products and make our beverages more widely available.

U.S. Industry Volume Growth
Soft Drinks vs. Alternative Beverages Compounded Annual Growth Rate (1993-1998)



Alternative beverages such as ready-to-drink teas and coffee drinks, bottled water, sports drinks and juice-based drinks continue to gain popularity.

Alternative beverages provided over 20% of Pepsi-Cola U.S. growth in 1998.

Lipton Brisk volume increased by 18% in 1998.

Aquafina is the leading non-jug water in the combined convenience store, gas station and independent business channels.

Through our partnership with Starbucks, we virtually created the ready-to-drink coffee category.

We continued to grow in the largest channel.

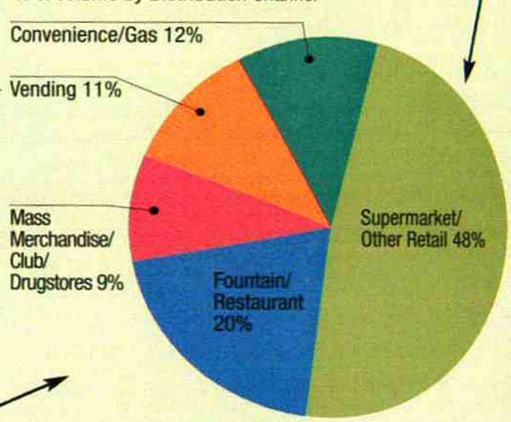
We are the leader in this channel.

The Pepsi-Cola system placed 190,000 new vendors and coolers.

We gained 9.6 share points in drugstores.

Volume was up 4%.

U.S. Pepsi-Cola Soft Drink Distribution
% of Volume by Distribution Channel



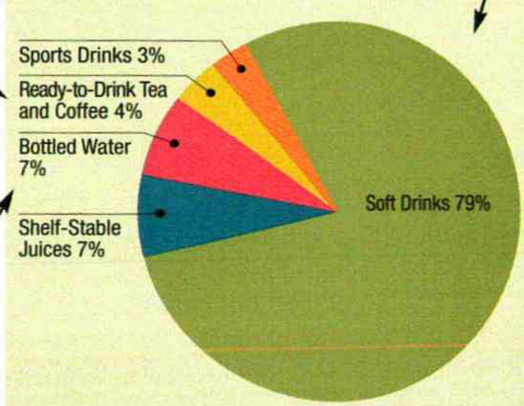
Pepsi-Cola generated growth across all major distribution channels.

Soft drinks, the largest category, account for more than $56 billion in retail sales.

Through our partnership with Lipton, we are the leader in ready-to-drink teas, with a market share that is 42% and growing.

Bottled water is the fastest growing beverage category.

U.S. Liquid Refreshment Beverage Industry
% Category Mix by Retail Sales



Soft drinks and alternative beverages are a huge industry, generating retail sales of more than $70 billion.

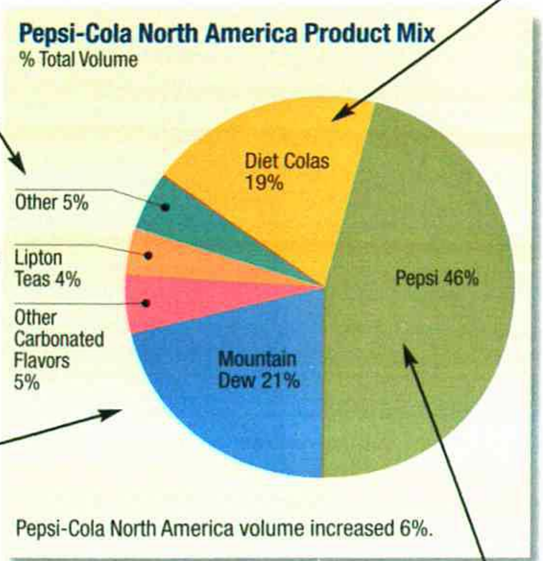
Aquafina grew over 80%. Frappuccino grew more than 70%.

Lipton ready-to-drink teas had the leading market share for the sixth year in a row.

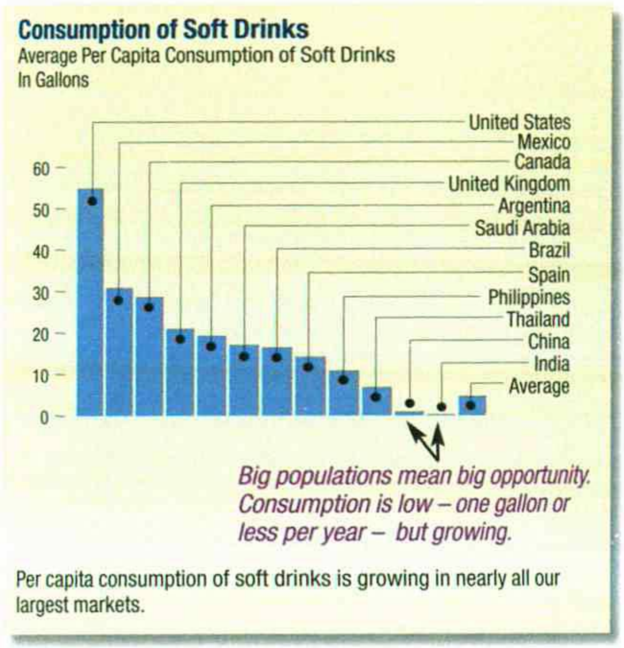
Our Mug brand root beer and cream soda grew 20%.

Since 1993, Mountain Dew volume has grown over 70%. A new look will expand its appeal even more.

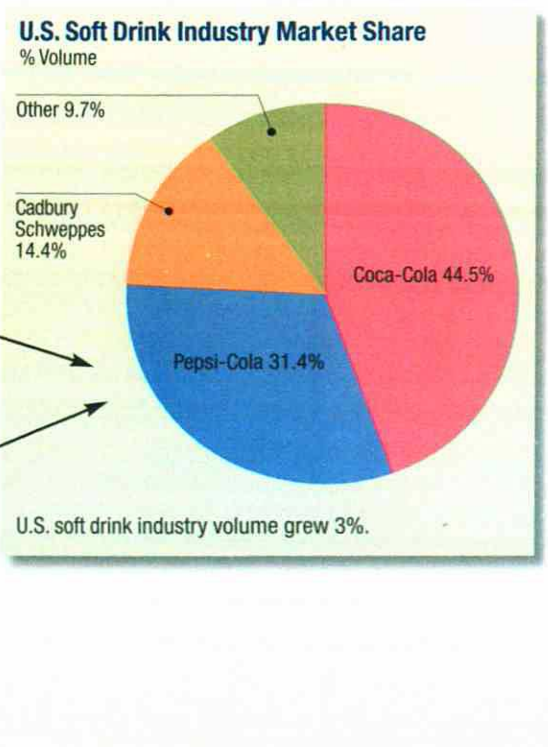
New Pepsi One re-energized the category.



We gave brand Pepsi a bright new look in its centennial year.



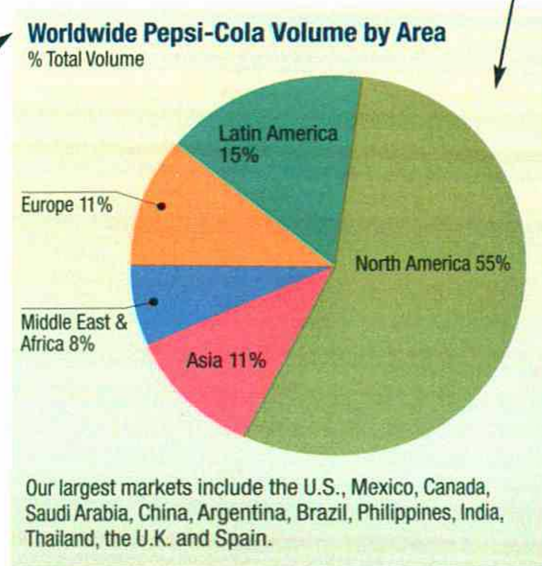
Retail sales of Pepsi-Cola products were over $31 billion worldwide; $21 billion was in North America.



Pepsi-Cola gained share.

Pepsi-Cola accounted for $18 billion in retail sales.

International markets had 6% volume growth.



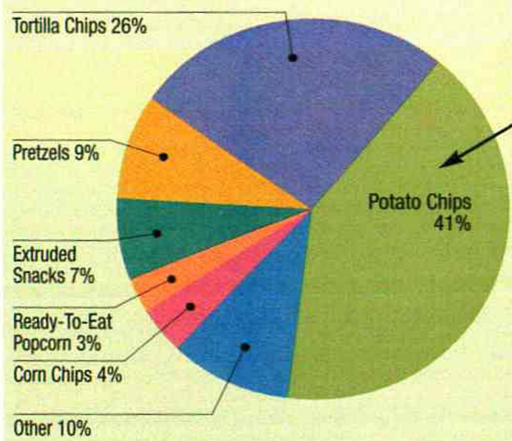
Frito-Lay

Lined Up for Growth

Frito-Lay is the world's leading snack chip company. We have both global and local brands, strong distribution systems and a variety of products to meet the needs of consumers.

We'll continue to grow by making our snack brands more widely available so consumers choose them for all snack occasions. We'll introduce new products that extend our categories. Internationally, we'll continue to enter new markets, expand our products in existing markets and build operational scale.

U.S. Snack Chip Industry
% Retail Sales



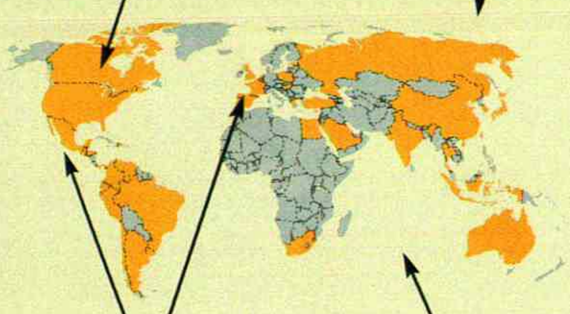
Frito-Lay has the leading brand in all major snack chip categories.

About 20% of industry sales are now low-fat, reduced-fat and fat-free potato chips – and Frito-Lay has the leading products.

Frito-Lay Worldwide Snack Chip Markets
Includes potato chips, tortilla chips, extruded snacks, pretzels.

The snack chip industry in the U.S. generates retail sales of more than $13 billion. Frito-Lay has a 60% share.

Frito-Lay is the market leader in more than half of the 42 countries in which we operate.



Our joint venture in Europe and our business in Mexico both had strong double-digit snack chip growth.

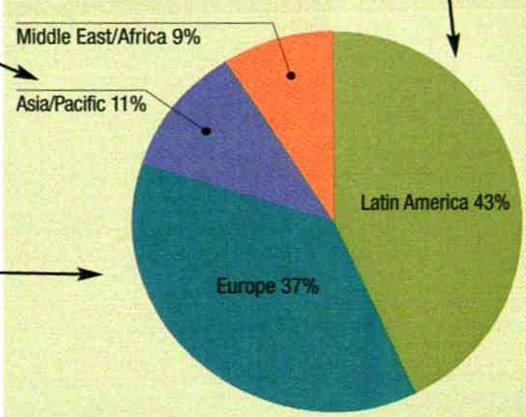
Retail sales of our snack chips outside North America are $4.9 billion.

The worldwide snack chip market generates $36 billion in retail sales. With a market share of more than 35%, Frito-Lay is the world's leading snack chip manufacturer.

Acquisitions and a joint venture raised our market share in South and Central America above 50%.

Frito-Lay International Market Mix
% of Total Snack Chip Kilo Volume by Region

An acquisition moved us to the Number 1 position in Australia, the world's eighth largest snack chip market.

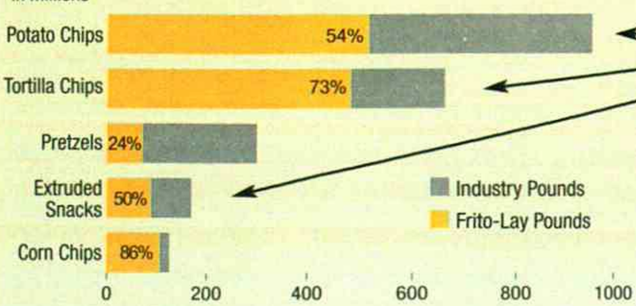


Our acquisition of snack businesses from United Biscuits expanded our leadership position in northern Europe.

Acquisitions and joint ventures are rapidly expanding our snack operations throughout the world.

Frito-Lay Share of Major Snack Chip Categories in U.S.

Frito-Lay Share of Total Industry Pounds In Major Supermarkets and Other Measured Channels
In Millions



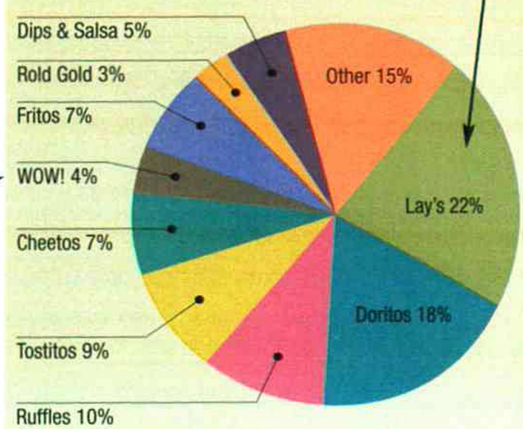
Frito-Lay brands provided 3% of the sales growth of packaged goods.

Frito-Lay volume growth outpaced industry growth.

Volume grew 10%.

Frito-Lay North America Product Mix

% of Sales Provided by Product

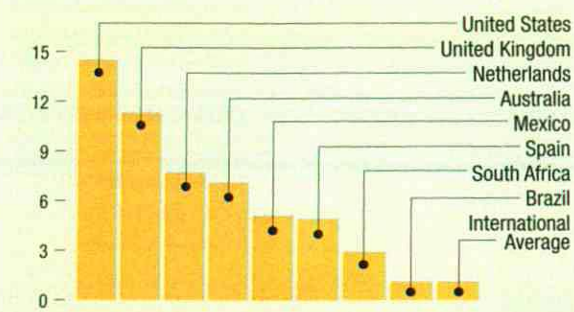


Frito-Lay North American sales grew at 7%.

First year sales made WOW! Frito-Lay's most successful new product ever.

Worldwide Per Capita Consumption of Snack Chips

Pounds Per Capita
Includes potato chips, tortilla chips and extruded snacks. Excludes pretzels.

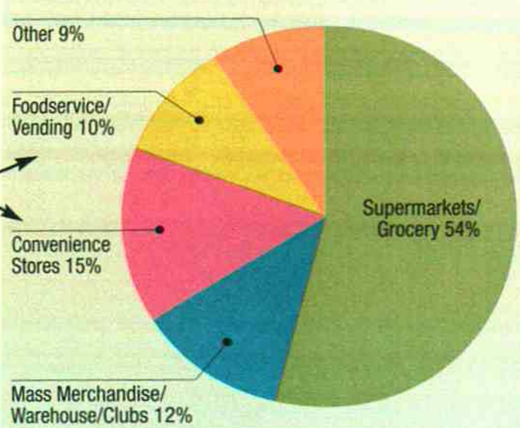


Relatively low per capita consumption in most of our major international markets means high potential for growth.

Outside North America, annual per capita consumption of snack chips is about one pound a year.

U.S. Frito-Lay Channels of Distribution

% Sales

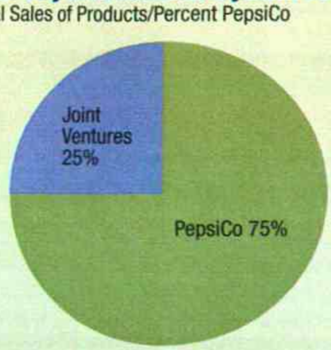


Supermarkets are the largest distribution channel, but we're tailoring our distribution system to serve customers of all sizes more efficiently.

Sales of our single-serve packages are growing rapidly as we expand distribution through these channels.

Frito-Lay International System Sales

Total Sales of Products/Percent PepsiCo



Frito-Lay International's joint ventures are largely in Europe and Latin America.

Tropicana

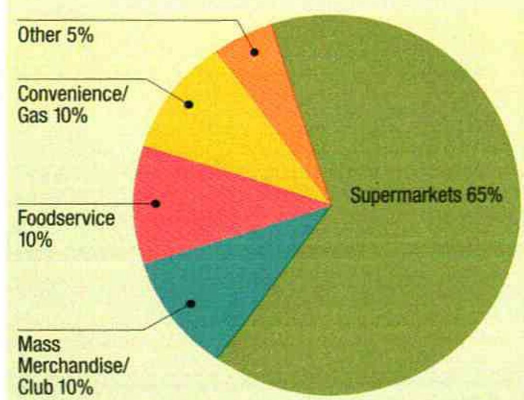
Lined Up for Growth

Tropicana Products, Inc., the world's largest marketer and producer of branded juices, joined the PepsiCo family in August 1998. It was acquired from The Seagram Company Ltd. for $3.3 billion.

Tropicana is an excellent strategic fit for PepsiCo. It dramatically expands our beverage presence into the morning, when consumption of traditional soft drinks is relatively low. It also significantly strengthens the range of products we can offer our millions of customers.

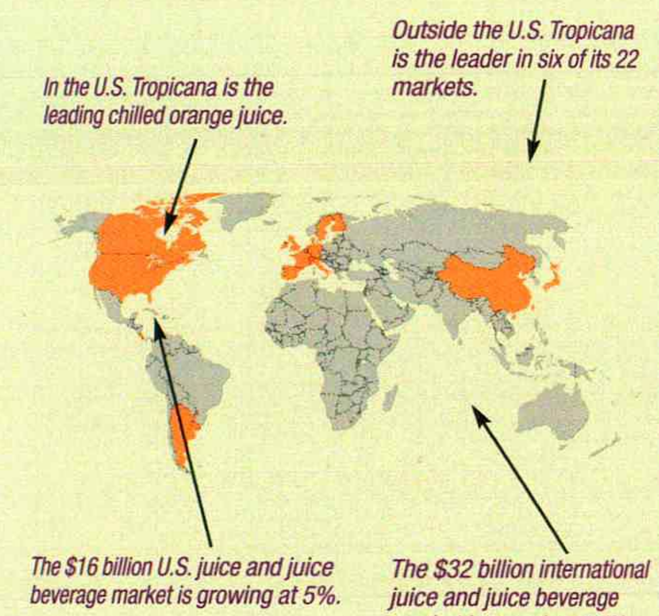
We see strong growth potential for Tropicana in both U.S. and international markets. We'll build our existing brands and develop new products, expand geographically and build scale to boost productivity and be more competitive.

U.S. Tropicana Distribution Channels
% Sales



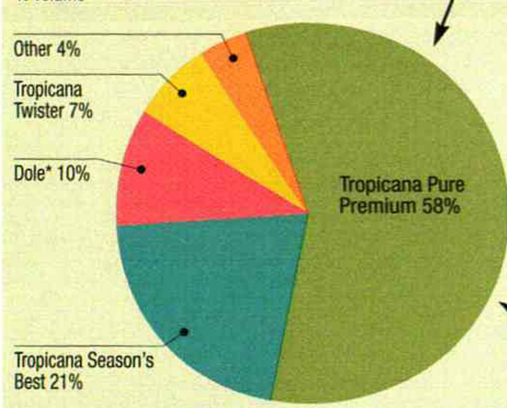
Tropicana generated growth across all major distribution channels.

Tropicana Countries of Operations



Tropicana Pure Premium retail sales are more than $1.2 billion in the U.S. and $1.6 billion worldwide.

Key U.S. Tropicana Brands
% Volume

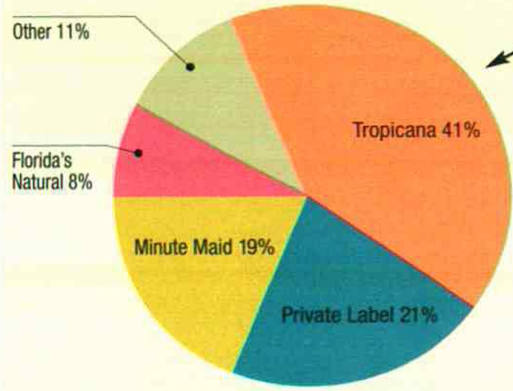


Tropicana brands grew at a compounded annual rate of more than 7% over the past five years.

* Used under license.

Tropicana Pure Premium is our largest, fastest growing and most profitable juice brand.

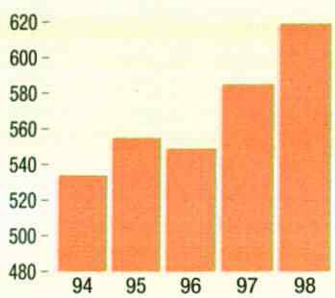
U.S. Chilled Orange Juice Competitors
% Retail Sales In Supermarkets



Tropicana is the leader in the $2.7 billion chilled orange juice supermarket channel.

Tropicana Pure Premium share has grown steadily since 1990.

U.S. Growth in Chilled Orange Juice
Gallons In Millions In Supermarkets

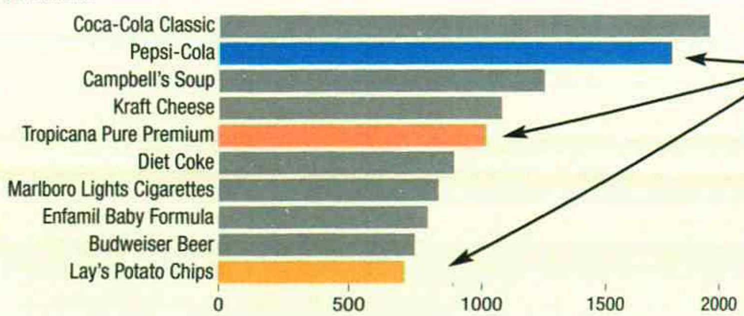


Chilled orange juice purchases in supermarkets, by far the largest channel, grew at a compounded annual rate of more than 3% over the past five years.

More than 40% of consumers now buy not-from-concentrate orange juice; 71% of these sales are Tropicana Pure Premium.

About 15% of Tropicana volume is generated outside the U. S.

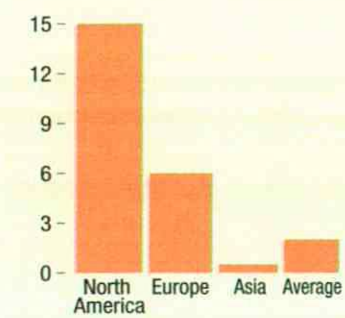
Brand Strength
Retail Sales of Leading Brands in Supermarkets
$ In Millions



Tropicana Pure Premium is the fifth largest brand sold in supermarkets.

PepsiCo owns three of the top 10 brands in U.S. supermarkets.

Worldwide Consumption Juice and Juice Beverages
Annual Gallons Per Capita



Tropicana has plenty of room to grow. Only one out of every five breakfasts in the U.S. includes orange juice, and consumption is even lower outside North America.

Principal Divisions and Corporate Officers

(Listings include age and years of PepsiCo experience.)

Executive Offices

PepsiCo, Inc.
Purchase, NY 10577
(914) 253-2000

Co-founder of PepsiCo, Inc.
Donald M. Kendall
Over 50 years of PepsiCo experience

Corporate Officers

Roger A. Enrico
Chairman of the Board and
Chief Executive Officer
54, 27 years

Karl M. von der Heyden
Vice Chairman of the Board
62, 8 years

William R. Bensyl
Senior Vice President, Personnel
53, 23 years

Albert P. Carey
Senior Vice President,
Sales and Retailer Strategies
47, 17 years

Matthew M. McKenna
Senior Vice President and Treasurer
48, 5 years

Indra K. Nooyi
Senior Vice President, Corporate
Strategy and Development
43, 5 years

Sean F. Orr
Senior Vice President and Controller
44, 4 years

Stephen Schuckenbrock
Senior Vice President,
Information Technology
and Chief Information Officer
38, 3 years

Robert F. Sharpe, Jr.
Senior Vice President, Public Affairs,
General Counsel and Secretary
47, 1 year

Michael D. White
Senior Vice President and
Chief Financial Officer
47, 9 years

Principal Divisions and Officers

Pepsi-Cola Company
700 Anderson Hill Road
Purchase, NY 10577
(914) 253-2000

Philip A. Marineau
President and Chief
Executive Officer
Pepsi-Cola North America
52, 1 year

Peter M. Thompson
President and Chief
Executive Officer
Pepsi-Cola International
52, 8 years

The Pepsi Bottling Group
1 Pepsi Way
Somers, NY 10589
(914) 767-6000

Craig E. Weatherup
Chairman and Chief
Executive Officer
53, 24 years

Craig D. Jung
Chief Operating Officer
45, 13 years

Frito-Lay Company
7701 Legacy Drive
Plano, TX 75024
(972) 334-7000

Steven S Reinemund
Chairman and Chief
Executive Officer
50, 14 years

James H. O'Neal
President and Chief
Executive Officer
Frito-Lay International
61, 32 years

William R. McLaughlin
President
Europe, Middle East, Africa Region
42, 10 years

Rogelio M. Rebolledo
President, Latin America and
Asia Pacific Regions
54, 22 years

Tropicana Products, Inc.
1001 13th Avenue East
Bradenton, FL 34208
(941) 747-4461

Gary M. Rodkin
President and Chief
Executive Officer
46, 3 years

PepsiCo, Inc. Board of Directors

(Listings include age and year elected PepsiCo director.)

John F. Akers
Former Chairman of the Board and
Chief Executive Officer
International Business Machines
64. Elected 1991

Robert E. Allen
Former Chairman of the Board
and Chief Executive Officer
AT&T Corp.
64. Elected 1990

Roger A. Enrico
Chairman of the Board and
Chief Executive Officer
PepsiCo, Inc.
54. Elected 1987

Peter Foy
Former Chairman
Baring Brothers International Ltd.
58. Elected 1997

Ray L. Hunt
Chairman and Chief Executive Officer
Hunt Oil Company
Chairman, Chief Executive Officer and President
Hunt Consolidated, Inc.
55. Elected 1996

John J. Murphy
Former Chairman of the Board and
Chief Executive Officer
Dresser Industries
67. Elected 1984

Steven S Reinemund
Chairman and Chief Executive Officer
Frito-Lay Company
50. Elected 1996

Sharon Percy Rockefeller
President and Chief Executive Officer
WETA Public Stations, Washington, DC
54. Elected 1986

Franklin A. Thomas
Consultant
TFF Study Group
64. Elected 1994

P. Roy Vagelos
Former Chairman of the Board and
Chief Executive Officer
Merck & Co.
69. Elected 1992

Karl M. von der Heyden
Vice Chairman of the Board
PepsiCo, Inc.
62. Elected 1996

Craig E. Weatherup
Chairman and Chief Executive Officer
The Pepsi Bottling Group
53. Elected 1996

Arnold R. Weber
President-Emeritus
Northwestern University
69. Elected 1978

Management's Discussion and Analysis

INTRODUCTION

Management's Discussion and Analysis is presented in four sections. The Introductory section discusses Pending Transactions/Events, Acquisitions, Market Risk (including the EURO conversion), Year 2000, Impairment and Other Items Affecting Comparability of Results and a New Accounting Standard (pages 13-16). The second section analyzes the Results of Operations, first on a consolidated basis and then for each of our business segments (pages 16-20). The final two sections address our Consolidated Cash Flows and Liquidity and Capital Resources (pages 20 and 21).

Cautionary Statements

From time to time, in written reports (including the Chairman's letter accompanying this annual report) and in oral statements, we discuss expectations regarding our future performance, Year 2000 risks, pending transactions/events, the impact of the EURO conversion and the impact of current global macro-economic issues. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from expectations.

Pending Transactions/Events

In November 1998, our Board of Directors approved a plan for the separation from PepsiCo of certain wholly-owned bottling businesses located in the United States, Canada, Spain, Greece and Russia, referred to as The Pepsi Bottling Group. Pursuant to this plan, PBG intends to sell shares of its common stock in an initial public offering and PepsiCo intends to retain a noncontrolling ownership interest in PBG. A registration statement relating to the Offering has been filed on Form S-1 with the Securities and Exchange Commission. The transaction is expected to be consummated in the second quarter of 1999, subject to market conditions and regulatory approval. If consummated, the transaction is expected to result in a gain to PepsiCo, net of related costs. These related costs will include a charge for the early vesting of PepsiCo stock options held by PBG employees, which will be based on the price of our stock at the date of the Offering. See Management's Discussion and Analysis – Liquidity and Capital Resources on page 21 regarding PBG related financing and expected use of proceeds.

In January 1999, we announced an agreement with the Whitman Corporation to realign bottling territories. Subject to approval by the Whitman shareholders and various regulatory authorities, we plan to combine certain of our bottling operations in the mid-western United States and Central Europe with most of Whitman's existing bottling businesses to create new Whitman. Under the agreement, our current equity interest of 20% in General Bottlers, the principal operating company of Whitman, will also be transferred to new Whitman. Whitman transferred its existing bottling operations in Marion, Virginia; Princeton, West Virginia; and St. Petersburg, Russia to PBG. It is planned for new Whitman to assume certain indebtedness associated with our transferred U.S. operations with net proceeds to us of \$300 million. Upon completion of the transaction, we will receive 54 million shares of new Whitman common stock. Whitman has undertaken a share repurchase program and it is anticipated that upon completion of the transaction and the repurchase program, our noncontrolling ownership interest will be approximately 40%. If approved, this transaction is expected to be completed in the second quarter of 1999 and result in a net gain to PepsiCo.

The Frito-Lay program to improve productivity, discussed in Management's Discussion and Analysis – Impairment and Other Items Affecting Comparability of Results on page 15, also includes consolidating U.S. production in our most modern and efficient plants and streamlining logistics and transportation systems. This program is expected to result in additional asset impairment and restructuring charges of approximately \$65 million to be recorded in the first quarter of 1999.

Acquisitions

At the end of the third quarter 1998, we completed the acquisitions of Tropicana Products, Inc. from the Seagram Company Ltd. for \$3.3 billion in cash and The Smith's Snackfoods Company (TSSC) in Australia from United Biscuits Holdings plc for \$270 million in cash. In addition, acquisitions and investments in unconsolidated affiliates included the purchases of the remaining ownership interest in various bottlers and purchases of other international salty snack food businesses. Acquisitions for the year aggregated \$4.5 billion in cash. The results of operations of all acquisitions are generally included in the consolidated financial statements from their respective dates of acquisition.

Market Risk

The principal market risks (i.e., the risk of loss arising from adverse changes in market rates and prices) to which we are exposed are:

- interest rates on our debt and short-term investment portfolios,
- foreign exchange rates and other international market risks, and
- commodity prices, affecting the cost of our raw materials.

Interest Rates

PepsiCo centrally manages its debt and investment portfolios balancing investment opportunities and risks, tax consequences and overall financing strategies.

We use interest rate and currency swaps to effectively modify the interest rate and currency of specific debt issuances with the objective of reducing our overall borrowing costs. These swaps are generally entered into concurrently with the issuance of the debt that they are intended to modify. The notional amount, interest payment and maturity dates of the swaps match the principal, interest payment and maturity dates of the related debt. Accordingly, any market risk or opportunity associated with these swaps is fully offset by the opposite market impact on the related debt.

Our investment portfolios consist of cash equivalents and short-term marketable securities. The carrying amounts approximate market value because of the short-term maturity of these portfolios. It is our practice to hold these investments to maturity.

Assuming year-end 1998 variable rate debt and investment levels, a one-point change in interest rates would impact net interest expense by \$64 million. This sensitivity analysis does not take into account existing interest rate swaps and the possibility that rates on debt and investments can move in opposite directions and that gains from one category may or may not be offset by losses from another category.

Foreign Exchange and Other International Market Risks

Operating in international markets involves exposure to movements

in currency exchange rates. Currency exchange rate movements typically affect economic growth, inflation, interest rates, governmental actions and other factors. These changes, if material, can cause us to adjust our financing and operating strategies. The discussion of changes in currency below does not incorporate these other important economic factors. The sensitivity analysis presented below does not take into account the possibility that rates can move in opposite directions and that gains from one category may or may not be offset by losses from another category.

International operations constitute about 15% of our 1998 consolidated operating profit, excluding unusual impairment and other items. As currency exchange rates change, translation of the income statements of our international businesses into U.S. dollars affects year-over-year comparability of operating results. We do not generally hedge translation risks because cash flows from international operations are generally reinvested locally. We do not enter into hedges to minimize volatility of reported earnings because we do not believe it is justified by the exposure or the cost.

Changes in currency exchange rates that would have the largest impact on translating our international operating profit include the Mexican peso, British pound, Canadian dollar and Brazilian real. We estimate that a 10% change in foreign exchange rates would impact reported operating profit by approximately $45 million. This was estimated using 10% of the international segment operating profit after adjusting for unusual impairment and other items. We believe that this quantitative measure has inherent limitations because, as discussed in the first paragraph of this section, it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

Foreign exchange gains and losses reflect transaction gains and losses and translation gains and losses arising from the remeasurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries. Transaction gains and losses arise from monetary assets and liabilities denominated in currencies other than a business unit's functional currency. There were net foreign exchange losses of $53 million in 1998, $16 million in 1997 and $1 million in 1996.

During the year, macro-economic conditions in Brazil, Mexico, Russia and across Asia Pacific have adversely impacted our results (see Russia discussion below). We are taking actions in these markets to respond to these conditions, such as prudent pricing aimed at sustaining volume, renegotiating terms with suppliers and securing local currency supply alternatives. However, we expect that the macro-economic conditions, particularly in Brazil, will continue to adversely impact our results in the near term.

The economic turmoil in Russia which accompanied the August 1998 devaluation of the ruble had an adverse impact on our operations. Consequently in our fourth quarter, we experienced a significant drop in demand, resulting in lower net sales and increased operating losses. Also, since net bottling sales in Russia are denominated in rubles, whereas a substantial portion of our related costs and expenses are denominated in U.S. dollars, bottling operating margins were further eroded. In response to these conditions, we have reduced our cost structure primarily through closing facilities, renegotiating manufacturing contracts and reducing the number of employees. We also wrote down our long-lived bottling assets to give effect to the resulting impairment. See Management's Discussion and Analysis – Impairment and Other Items Affecting Comparability of Results on page 15.

On January 1, 1999, eleven of fifteen member countries of the European Union fixed conversion rates between their existing currencies ("legacy currencies") and one common currency – the EURO. The EURO trades on currency exchanges and may be used in business transactions. Conversion to the EURO eliminated currency exchange rate risk between the member countries. Beginning in January 2002, new EURO-denominated bills and coins will be issued, and legacy currencies will be withdrawn from circulation. Our operating subsidiaries affected by the EURO conversion have established plans to address the issues raised by the EURO currency conversion. These issues include, among others, the need to adapt computer and financial systems, business processes and equipment, such as vending machines, to accommodate EURO-denominated transactions and the impact of one common currency on pricing. Since financial systems and processes currently accommodate multiple currencies, the plans contemplate conversion by the middle of 2001 if not already addressed in conjunction with Year 2000 remediation. We do not expect the system and equipment conversion costs to be material. Due to numerous uncertainties, we cannot reasonably estimate the long-term effects one common currency will have on pricing and the resulting impact, if any, on financial condition or results of operations.

Commodities

We are subject to market risk with respect to commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use futures contracts to hedge immaterial amounts of our commodity purchases.

Year 2000

Each of PepsiCo's business segments and corporate headquarters has established teams to identify and address Year 2000 compliance issues. Information technology systems with non-compliant code are expected to be modified or replaced with systems that are Year 2000 compliant. Similar actions are being taken with respect to non-IT systems, primarily systems embedded in manufacturing and other facilities. The teams are also charged with investigating the Year 2000 readiness of suppliers, customers, franchisees, financial institutions and other third parties and with developing contingency plans where necessary.

Key information technology systems have been inventoried and assessed for compliance, and detailed plans have been established for required system modifications or replacements. Remediation and testing activities are in process with work on approximately 70% of the systems already completed and the systems back in operation. This percentage is expected to increase to approximately 85% and 98% by the end of the first and second quarters of 1999, respectively. PepsiCo systems are expected to be compliant by the fourth quarter of 1999. Inventories and assessments of non-IT systems have been completed and remediation activities are under way with a mid-year 1999 target completion date.

Independent consultants have monitored progress of remediation programs at selected businesses and performed testing at certain key locations. In addition, other experts performed independent verifica-

tion and validation audits of a sample of remediated systems with satisfactory results. Other independent consultants also performed a high-level review of our Year 2000 efforts and concluded that there were no significant deficiencies in our process, provided that resources are maintained at their current level and schedules are met. Progress is also monitored by senior management, and periodically reported to PepsiCo's Board of Directors.

We have identified critical suppliers, customers, financial institutions, and other third parties and have surveyed their Year 2000 remediation programs. We have completed on-site meetings with many of the third parties identified as presenting the greatest impact if not compliant. Risk assessments and contingency plans, where necessary, will be finalized in the first half of 1999 and tested where feasible in the second half of 1999. In addition, independent consultants have completed a survey of the state of readiness of our significant bottling franchisees. Such surveys have identified readiness issues and, therefore, potential risk to us. As a result, the franchisees' remediation programs are being accelerated to minimize the risk. We are also providing assistance to the franchisees with processes and with certain manufacturing equipment compliance data.

Incremental costs directly related to Year 2000 issues are estimated to be $141 million from 1998 to 2000, of which $64 million or 45% has been spent to date. Approximately 35% of the total estimated spending represents costs to repair systems while approximately 50% represents costs to replace and rewrite software. This estimate assumes that we will not incur significant Year 2000 related costs on behalf of our suppliers, customers, franchisees, financial institutions or other third parties. Costs incurred prior to 1998 were immaterial. Excluded from the estimated incremental costs are approximately $55 million of internal recurring costs related to our Year 2000 efforts.

Contingency plans for Year 2000 related interruptions are being developed and will include, but not be limited to, the development of emergency backup and recovery procedures, the staffing of a centralized team to react to unforeseen events, remediation of existing systems parallel with installation of new systems, replacing electronic applications with manual processes, identification of alternate suppliers and increasing raw material and finished goods inventory levels. The potential failure of a power grid or public telecommunication system, particularly internationally, will be considered in our contingency planning. All plans are expected to be completed by the end of the second quarter in 1999.

Our most likely worst case scenarios are the temporary inability of bottling franchisees to manufacture or bottle some products in certain locations, of suppliers to provide raw materials on a timely basis and of some customers to order and pay on a timely basis.

Our Year 2000 efforts are ongoing and our overall plan, including our contingency plans, will continue to evolve as new information becomes available. While we anticipate no major interruption of our business activities, that will be dependent in part upon the ability of third parties, particularly bottling franchisees, to be Year 2000 compliant. Although we have implemented the actions described above to address third party issues, we are not able to require the compliance actions by such parties. Accordingly, while we believe our actions in this regard should have the effect of mitigating Year 2000 risks, we are unable to eliminate them or to estimate the ultimate effect Year 2000 risks will have on our operating results.

Impairment and Other Items Affecting Comparability of Results

Asset Impairment and Restructuring Charges

Asset impairment and restructuring charges were $288 million ($261 million after-tax or $0.17 per share) in 1998, $290 million ($239 million after-tax or $0.15 per share) in 1997 and $576 million ($527 million after-tax or $0.33 per share) in 1996.

The 1998 asset impairment and restructuring charges of $288 million are comprised of the following:

- A fourth quarter charge of $218 million for asset impairment of $200 million and restructuring charges of $18 million resulting from the adverse impact of market conditions of our Russian bottling operations described in Management's Discussion and Analysis – Market Risks on pages 13 and 14. The impairment evaluation was triggered by the reduction in utilization of assets caused by the lower demand, the adverse change in the business climate and the expected continuation of operating losses and cash deficits in that market. The impairment charge reduced the net book value of the assets to their estimated fair market value, based primarily on values recently paid for similar assets in that marketplace. Of the total $218 million charge, $212 million relates to bottling operations that will be part of PBG.
- An impairment charge of $54 million relating to manufacturing equipment at Frito-Lay North America. In the fourth quarter, as part of our annual assessment of marketing plans and related capacity requirements at Frito-Lay North America and the development of a program to improve manufacturing productivity, we determined that certain product specific equipment would not be utilized and certain capital projects would be terminated to avoid production redundancies. The charge primarily reflects the write off of the net book value of the equipment and related projects.
- A fourth quarter charge of $16 million for employee related costs resulting from the separation of Pepsi-Cola North America's concentrate and bottling organizations to more effectively serve retail customers in light of the expected conversion of PBG to public ownership. Of this amount, $10 million relates to bottling operations that will be part of PBG.

Most of the 1998 restructuring related amounts have been or will be paid in 1999.

In 1997 and 1996, asset impairment and restructuring charges of $290 million and $576 million reflected strategic decisions to realign the international bottling system, improve Frito-Lay International operating productivity and exit certain businesses. In 1997, restructuring charges included proceeds of $87 million associated with a settlement related to a previous Venezuelan bottler agreement, partially offset by related costs.

Income Tax Benefit

In 1998 we reported a tax benefit, included in the provision for income taxes, of $494 million (or $0.32 per share) as a result of reaching a final agreement with the Internal Revenue Service to settle substantially all remaining aspects of a tax case relating to our concentrate operations in Puerto Rico.

New Accounting Standard

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities.* SFAS 133 is effective for our fiscal year beginning 2000. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that we recognize all derivative instruments as either assets or liabilities in the balance sheet and measure those instruments at fair value. We are currently assessing the effects of adopting SFAS 133, and have not yet made a determination of the impact adoption will have on our consolidated financial statements.

RESULTS OF OPERATIONS

Consolidated Review

General

In the discussions below, the year-over-year dollar change in bottler case sales by company-owned bottling operations and concentrate unit sales to franchisees for Pepsi-Cola, and in pound or kilo sales of salty and sweet snacks for Frito-Lay is referred to as *volume.* Price changes over the prior year and the impact of product, package and country sales mix changes are referred to as *effective net pricing.*

Net Sales

				% Change B/(W)	
($ in millions)	1998	1997	1996	1998	1997
Net sales	$22,348	$20,917	$20,337	7	3

Net sales rose $1.4 billion or 7% in 1998. Excluding foreign currency impact, net sales would have risen 8%. This increase reflects volume gains in all businesses, net contributions from acquisitions/divestitures and higher effective net pricing driven by a shift to higher-priced products in Frito-Lay North America. Volume gains contributed 4 percentage points of growth. Net acquisitions/divestitures contributed 3 percentage points to the sales growth and primarily reflect the acquisitions of Tropicana and certain North American bottlers partially offset by the absence of bottling sales as a result of refranchising a Japanese bottler late in 1997. In addition, net acquisitions/divestitures also include the addition of TSSC and certain other international salty snack food businesses which were partially offset by the loss of net sales from previously consolidated businesses contributed to a new Frito-Lay International joint venture in Central and South America. Weaker foreign currencies primarily in Canada, Thailand, Brazil, Poland and India led the unfavorable foreign currency impact.

Net sales rose $580 million or 3% in 1997. Excluding foreign currency impact, net sales would have risen 4%. This increase reflects volume gains in Frito-Lay Worldwide and Pepsi-Cola North America and higher effective net pricing. Weaker foreign currencies primarily in Spain, Japan, Germany and Hungary led the unfavorable foreign currency impact.

Operating Profit and Margin

				Change B/(W)	
($ in millions)	1998	1997	1996	1998	1997
Reported					
Operating Profit	$2,584	$2,662	$2,040	(3.0)%	30%
Operating Profit Margin	11.6%	12.7%	10.0%	(1.1)	2.7
Ongoing					
Operating Profit	$2,872	$2,952	$2,616	(3.0)%	13%
Operating Profit Margin	12.9%	14.1%	12.9%	(1.2)	1.2

Ongoing excludes the effect in all years of impairment and other items affecting comparability (see Note 3).

In 1998, reported operating profit margin decreased over 1 percentage point. Ongoing operating profit margin declined over 1 percentage point primarily reflecting the margin impact of increased advertising and marketing (A&M) and selling and distribution (S&D) expenses and higher cost of sales partially offset by the impact of volume growth. A&M grew at a significantly faster rate than sales led by increases at Pepsi-Cola Worldwide which included the Pepsi One launch costs and increases at Frito-Lay North America for promotional allowances and "WOW!" launch costs. S&D expenses grew at a slightly faster rate than sales primarily in Pepsi-Cola North America and in Frito-Lay North America, reflecting an increase in our sales forces and higher depreciation, maintenance and labor costs associated with Pepsi-Cola North America cooler and vendor placements. Cost of sales as a percentage of sales increased due to costs associated with new plants and lines related to "WOW!" and Doritos 3-D products at Frito-Lay North America and an unfavorable shift from higher-margin concentrate business to packaged products in Pepsi-Cola North America. Excluding foreign exchange losses, ongoing operating profit would have declined 1%. Foreign exchange losses, primarily in Russia and Asia, are reported as part of Corporate unallocated expenses. Information technology expense increased on year-over-year basis, despite $42 million of software costs that were capitalized as required by SOP 98-1, driven by our various productivity initiatives and Year 2000 remediation efforts.

Reported operating profit margin increased over 2½ percentage points in 1997. Ongoing operating profit margin increased over 1 percentage point due to the margin impact of volume growth in all businesses, equity income from investments in unconsolidated affiliates compared to losses in 1996 and lower cost of sales. The impact of these advances were partially offset by the impact of higher S&D and G&A. The change in equity income primarily reflects the absence of losses in 1997 from our Latin American bottler, Buenos Aires Embotelladora S.A. (BAESA). Cost of sales as a percentage of sales decreased due to favorable raw material costs in Pepsi-Cola International and the favorable effect of higher pricing partially offset by increased costs for new plant capacity and the planned introduction of new products in 1998 by Frito-Lay North America. The higher S&D was driven by increased distribution costs to meet demand. The increase in G&A is due to information systems-related expenses, customer focus leadership training and infrastructure costs related to our new fountain beverage sales team. These increased G&A

expenses were partially offset by savings from a prior year restructuring and the consolidation of certain administrative functions. Ongoing operating profit margin was also reduced by the absence of 1996 gains from the sale of an investment in a U.S. bottling cooperative, a settlement with a Pepsi-Cola North America supplier and the sale of a non-core business at Frito-Lay North America.

Interest Expense, net

				% Change B/(W)	
($ in millions)	**1998**	1997	1996	**1998**	1997
Interest expense	**$(395)**	$(478)	$(565)	**17**	15
Interest income	**74**	125	91	**(41)**	37
Interest expense, net	**$(321)**	$(353)	$(474)	**9**	26

Interest expense, net of interest income, declined $32 million in 1998. The decline in interest expense was primarily due to lower average U.S. debt levels, as a result of using cash flows received from discontinued operations in the latter half of 1997 to repay debt. The lower U.S. debt levels were maintained until the end of the third quarter when the debt level increased to finance several acquisitions (see Management's Discussion and Analysis – Acquisitions on page 13). This decline was partially offset by higher average interest rates on the remaining debt. Interest income declined $51 million reflecting lower U.S. and international investment levels as a result of utilizing investment balances to make acquisitions and repay debt. See Management's Discussion and Analysis – Liquidity and Capital Resources on page 21 for disclosure related to 1999 debt offerings.

In 1997 interest expense, net of interest income, declined $121 million. Interest expense declined $87 million primarily reflecting lower average U.S. debt levels. Debt levels were reduced by using a portion of the cash flows provided by discontinued operations and from proceeds repatriated from our investments in Puerto Rico. The repatriation of funds resulted from a 1996 change in tax law which eliminated a tax exemption on investment income in Puerto Rico. Interest income increased $34 million reflecting higher investment levels, which also benefited from the cash flows provided by discontinued operations.

Provision for Income Taxes

($ in millions)	**1998**	1997	1996
Reported			
Provision for income taxes	**$270**	$818	$624
Effective tax rate	**11.9%**	35.4%	39.8%
Ongoing			
Provision for income taxes	**$791**	$ 869	$ 673
Effective tax rate	**31.0%**	33.4%	31.4%

Ongoing excludes the effect in all years of impairment and other items affecting comparability (see Note 3).

In 1998, the reported effective tax rate decreased 23.5 percentage points primarily as a result of a tax benefit of $494 million (or $0.32 per share). The tax benefit reflects a final agreement with the Internal Revenue Service to settle substantially all remaining aspects of a tax case relating to our concentrate operations in Puerto Rico. The ongoing effective tax rate declined 2.4 percentage points attributable to favorable settlement of prior years' audit issues, including issues related to the deductibility of purchased franchise rights.

For 1997, the reported effective tax rate decreased 4.4 percentage points to 35.4%. The ongoing effective tax rate increased 2.0 percentage points to 33.4%, primarily reflecting the absence of cumulative tax credits recognized in 1996 that related to prior years and lower benefits in 1997 from the resolution of prior years' audit issues.

Income from Continuing Operations and Income Per Share

				% Change B/(W)	
($ in millions except per share amounts)	**1998**	1997	1996	**1998**	1997
Income from continuing operations					
Reported	**$1,993**	$1,491	$ 942	**34**	58
Ongoing	**$1,760**	$1,730	$1,469	**2**	18
Income per share from continuing operations					
Reported	**$ 1.31**	$ 0.95	$ 0.59	**38**	62*
Ongoing	**$ 1.16**	$ 1.10	$ 0.92	**5**	20

Ongoing excludes the effect in all years of impairment and other items affecting comparability (see Note 3).
* Based on unrounded amounts.

For 1998, reported income from continuing operations increased $502 million while income per share increased $0.36. Ongoing income from continuing operations and income per share increased $30 million and $0.06, respectively. The ongoing increases are due to the lower effective tax rate and the benefit from a 3% reduction in average shares outstanding, partially offset by lower operating profit.

For 1997, reported income from continuing operations increased $549 million while income per share increased $0.36. Ongoing income from continuing operations and income per share increased $261 million and $0.18, respectively. The ongoing increases are due to the increase in operating profit and the lower net interest expense, partially offset by the higher effective tax rate. In addition, income per share also benefited from a 2% reduction in average shares outstanding.

Net Income and Net Income Per Share

				% Change B/(W)	
($ in millions except per share amounts)	**1998**	1997	1996	**1998**	1997
Net income	**$1,993**	$2,142	$1,149	**(7)**	86
Net income per share	**$ 1.31**	$ 1.36	$ 0.72	**(4)**	91*
Average shares outstanding used to calculate net income per share	**1,519**	1,570	1,606	**3**	2

* Based on unrounded amounts.

For 1997 and 1996, Net Income and Income Per Share include the results of income from discontinued operations, which primarily reflects the operating results of TRICON's core restaurant businesses through October 6, 1997 and the operating results and a gain on sale of the restaurant distribution operation sold in the second quarter of 1997. Discontinued operations also include the expenses associated with the spin-off and interest expense directly related to the restaurants segment.

Business Segments [a]

($ in millions)	1998	1997	1996	1995	1994
NET SALES					
Pepsi-Cola					
North America [b]	$ 8,266	$ 7,899	$ 7,788	$ 7,485	$7,119
International	2,385	2,642	2,799	2,982	2,535
	10,651	10,541	10,587	10,467	9,654
Frito-Lay					
North America [b]	7,474	6,967	6,628	5,873	5,379
International	3,501	3,409	3,122	2,727	2,951
	10,975	10,376	9,750	8,600	8,330
Tropicana [c]	722	–	–	–	–
Combined Segments	$22,348	$20,917	$20,337	$19,067	$17,984
OPERATING PROFIT [d]					
Pepsi-Cola					
North America [b]	$ 1,211	$ 1,274	$ 1,428	$ 1,249	$1,115
International	(219)	(144)	(846)	117	136
	992	1,130	582	1,366	1,251
Frito-Lay					
North America [b]	1,424	1,388	1,286	1,149	1,043
International	367	318	346	301	354
	1,791	1,706	1,632	1,450	1,397
Tropicana [c]	40	–	–	–	–
Combined Segments	$ 2,823	$ 2,836	$ 2,214	$ 2,816	$2,648

(a) Certain reclassifications were made to 1997 through 1994 amounts to conform with the 1998 presentation and to maintain comparability.
(b) North America is composed of operations in the U.S. and Canada.
(c) Represents results since the acquisition date. See Management's Discussion and Analysis – Acquisitions on page 13.
(d) Represents reported amounts. See Note 16 – Business Segments for 1998, 1997 and 1996 impairment and restructuring charges by segment. In addition, 1995 segment operating profit excludes the $66 charge for the initial, noncash impact of adopting SFAS 121 and 1994 includes an $18 gain on a stock offering by BAESA in Pepsi-Cola International.

PEPSI-COLA

See Management's Discussion and Analysis – Pending Transactions/ Events on page 13.

The standard volume measure is system bottler case sales (BCS). It represents PepsiCo-owned brands, as well as brands, that we have been granted the right to produce, distribute and market nationally.

PEPSI-COLA NORTH AMERICA

				% Growth Rates	
($ in millions)	1998	1997	1996	1998	1997
Net Sales	$8,266	$7,899	$7,788	5	1
Operating Profit					
Reported	$1,211	$1,274	$1,428	(5)	(11)
Ongoing	$1,227	$1,326	$1,428	(7)	(7)

Ongoing excludes unusual impairment and other items of $16 in 1998 and $52 in 1997 (see Note 3). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.

1998 vs. 1997

Net sales increased $367 million or 5%. The increase reflects significant volume growth and contributions from acquisitions, reduced by unfavorable foreign exchange rates with Canada and lower effective net pricing. The increased sales volume was primarily in packaged products. Acquisitions contributed 1 percentage point to the sales growth.

BCS increased 6%, led by the strong single-digit growth of the Mountain Dew brand, contributions from Pepsi One (our new one-calorie cola) and strong double-digit growth of Aquafina bottled water and Lipton Brisk. Brand Pepsi and brand Diet Pepsi also contributed to this year's growth, both advancing at single-digit rates. Concentrate shipments to franchisees grew at a slightly faster rate than their BCS growth.

Reported operating profit decreased $63 million. Ongoing operating profit declined $99 million primarily due to planned increases in S&D and A&M and higher G&A costs, partially offset by volume growth. S&D grew faster than sales and volume, due to an increase in our sales force and higher depreciation, maintenance and labor costs associated with cooler and vendor placements. A&M expenses grew significantly faster than sales and volume reflecting new product launches, such as Pepsi One, and planned increases for Project Globe and Pop Culture promotions. The G&A growth includes higher spending on information systems related to the Year 2000 and other projects and higher costs associated with the continued building of our fountain business infrastructure.

1997 vs. 1996

Net sales increased $111 million reflecting volume growth, led by take-home packaged products, reduced by lower effective net pricing. The decrease in effective net pricing was primarily in take-home packaged products, reflecting an intensely competitive environment.

BCS increased 4%, primarily reflecting double-digit growth by the Mountain Dew brand. Non-carbonated soft drink products, led by Aquafina bottled water and Lipton Brisk tea, grew at a double-digit rate. Our concentrate shipments to franchisees grew at a slower rate than their BCS growth during the year.

Reported operating profit declined $154 million. Ongoing operating profit declined $102 million, reflecting the lower effective net pricing, higher S&D costs and increased A&M. S&D grew significantly

faster than sales, but in line with volume. A&M grew significantly faster than sales and volume, primarily reflecting above average levels of expenditures late in 1997. These unfavorable items were reduced by the volume gains and lower packaging and commodity costs. G&A savings from centralizing certain administrative functions were fully offset by Year 2000 spending and infrastructure development costs related to our new fountain business sales team. The decline in ongoing operating profit is also due to the absence of 1996 gains from the sale of an investment in a bottling cooperative and a settlement made with a supplier.

PEPSI-COLA INTERNATIONAL

($ in millions)	1998	1997	1996	% Growth Rates 1998	% Growth Rates 1997
Net Sales	$2,385	$2,642	$2,799	(10)	(6)
Operating Profit					
Reported	$ (219)	$ (144)	$ (846)	(52)	83
Ongoing	$ (1)	$ 10	$ (270)	NM	NM

Ongoing excludes unusual impairment and other items of $218 in 1998, $154 in 1997 and $576 in 1996 (see Note 3). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.
NM – Not Meaningful

1998 vs. 1997

Net sales declined $257 million or 10%. Excluding foreign currency impact, net sales would have declined 7%. This decline was primarily due to the absence of Japan bottling sales in 1998 as a result of the refranchising of our Japanese bottler late in 1997. Volume gains partially offset the decline in net sales. Weaker foreign currencies primarily in Thailand, India and Hungary led the unfavorable foreign currency impact.

BCS increased 6% reflecting double-digit growth in Mexico, the Philippines, India, Pakistan and China. In addition, BCS grew at a high double-digit rate in Venezuela reflecting the continued momentum by the joint venture as it increased its territories and capacity. These advances were partially offset by lower BCS in Japan due to the elimination of certain PepsiCo-owned brands by the new bottler Suntory. The PepsiCo-owned brands that continued to be sold by Suntory grew at a double-digit rate. Total concentrate shipments to franchisees increased at about the same rate as their BCS.

Reported operating results declined $75 million. Ongoing operating results declined $11 million. The decline primarily reflects higher losses in Russia due to our increased ownership as well as the impact of the economic crisis. Excluding the impact of Russia, operating results would have increased driven by volume gains (reported by most of our Business Units) and lower G&A expenses, due in part to savings from our 1996 restructuring. These gains were partially reduced by higher A&M, increased equity losses from unconsolidated affiliates and lower effective net pricing.

1997 vs. 1996

Net sales declined $157 million or 6%. Excluding foreign currency impact, net sales would have increased 1% driven by volume gains. The unfavorable foreign currency impact was led by Spain and Japan.

BCS increased 1%. Strong double-digit growth in China, the Philippines and India was reduced by double-digit declines in Brazil, Venezuela and South Africa. The decline in Venezuela reflects the impact of the loss of our bottler in August 1996 while the decline in South Africa results from the cessation of our joint venture operation. In November 1996, we entered into a new joint venture to replace the Venezuelan bottler. Total concentrate shipments to franchisees increased at about the same rate as their BCS.

Reported operating losses declined $702 million. Ongoing operating results improved by $280 million, reflecting a small profit in 1997 compared to a loss in 1996. The improvement in ongoing operating results was driven by lower manufacturing costs, reduced net losses from our investments in unconsolidated affiliates and lower G&A expenses. Operating results also benefited from the absence of 1996's higher-than-normal expenses from fourth quarter balance sheet adjustments and actions. The lower manufacturing costs were primarily due to favorable raw material costs and lower depreciation resulting from certain businesses held for disposal. The reduced net losses from our unconsolidated affiliates were primarily driven by the absence of losses from BAESA. The lower G&A expenses reflect savings from our fourth quarter 1996 restructuring of about $70 million.

FRITO-LAY

The standard volume measure is pounds for North America and kilos for International. Pound and kilo growth are reported on a systemwide and constant territory basis, which includes currently consolidated businesses and unconsolidated affiliates reported for at least one year.

FRITO-LAY NORTH AMERICA

($ in millions)	1998	1997	1996	% Growth Rates 1998	% Growth Rates 1997
Net Sales	$7,474	$6,967	$6,628	7	5
Operating Profit					
Reported	$1,424	$1,388	$1,286	3	8
Ongoing	$1,478	$1,410	$1,286	5	10

Ongoing excludes unusual impairment and other items of $54 in 1998 and $22 in 1997 (see Note 3). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.

1998 vs. 1997

Net sales grew $507 million due to increased volume and a favorable mix shift to higher-priced products.

Pound volume advanced 5% led by core brand growth and "WOW!" products. The growth in core brands, excluding their low-fat and no-fat versions, was led by double-digit growth in Lay's brand potato chips and double-digit growth in Doritos brand tortilla chips. These gains were partially offset by declines in Ruffles brand potato chips, "Baked" Lay's and "Baked" Tostitos brand products and the elimination of Doritos Reduced Fat brand tortilla chips.

Reported operating profit increased $36 million. Ongoing operating profit increased $68 million reflecting the higher volume and the favorable mix shift, partially offset by increased operating costs. The increase in operating costs was led by increased A&M, higher manufacturing costs, reflecting costs associated with new plants and lines related to "WOW!" and Doritos 3-D products, and higher S&D

expenses. A&M grew at a significantly faster rate than sales and volume due to increased promotional allowances and "WOW!" launch costs. S&D grew at a slightly slower rate than sales but faster than volume.

1997 vs. 1996

Net sales grew $339 million reflecting increased volume and the benefit of higher pricing taken on most major brands late in 1996.

Pound volume advanced 3%. Growth of our core brands, excluding their low-fat and no-fat versions, was led by high single-digit growth in Lay's brand potato chips, strong double-digit growth by Tostitos brand tortilla chips and single-digit growth by Doritos brand tortilla chips. "Baked" Lay's brand potato crisps reported low double-digit growth. However, the remainder of our low-fat and no-fat snacks business depressed the overall growth rate.

Reported operating profit grew $102 million. Ongoing operating profit rose $124 million, reflecting the higher pricing and volume growth, partially offset by increased manufacturing costs and G&A expenses. The increased manufacturing costs related to new plant capacity and the planned introduction of new products in 1998. S&D grew slower than sales, A&M was about even with prior year and G&A increased significantly faster than sales reflecting information systems-related expenses and customer focus leadership training. Operating profit growth was hampered by the absence of a 1996 gain from the sale of a non-core business.

FRITO-LAY INTERNATIONAL

($ in millions)	1998	1997	1996	% Growth Rates 1998	% Growth Rates 1997
Net Sales	$3,501	$3,409	$3,122	3	9
Operating Profit					
Reported	$ 367	$ 318	$ 346	15	(8)
Ongoing	$ 367	$ 380	$ 346	(3)	10

Ongoing excludes unusual impairment and other items of $62 in 1997 (see Note 3). Unless otherwise noted, operating profit comparisons within the following discussions are based on ongoing operating profit.

1998 vs. 1997

Net sales increased $92 million or 3%. The increase in net sales was driven by net contributions from acquisitions/divestitures and by higher volume. The increase was partially offset by the impact of weaker foreign currencies including the unfavorable effect in Mexico of the devaluation of the peso against the U.S. dollar net of local pricing actions. Excluding Mexico, the impact of weaker foreign currencies, primarily Brazil, Poland, Australia and Thailand, reduced net sales growth by 2 percentage points. Net acquisitions/divestitures contributed 3 percentage points to the sales growth.

Salty snack kilos increased 6%, led by solid double-digit growth at Sabritas in Mexico and the Snack Ventures Europe joint venture, partially offset by double-digit declines in Brazil. Sweet snack kilos declined 2% driven by a single-digit decline at Gamesa in Mexico and a double-digit decline at Wedel in Poland. These declines in sweet snack kilos were partially offset by double-digit growth at Sabritas. Including acquisitions/divestitures, salty snack kilos increased to 14%. The increase of 8 percentage points was primarily driven by the acquisitions through partnership with, as well as, purchase of salty snack food businesses in Central and South America. Sweet snack kilos, including the effect of acquisitions/divestitures, declined 8% primarily as a result of the first quarter sale of a French biscuit business.

Reported operating profit increased $49 million. Ongoing operating profit declined $13 million. Deterioration of operating performance in Brazil due to the macro-economic conditions and market softness at Gamesa was partially offset by growth at Sabritas and in Poland. The growth in Poland was substantially driven by the sweet snack business. As part of our global strategy to focus on core businesses, we previously announced that we had completed negotiations for the sales in early 1999 of the chocolate and biscuit businesses in Poland.

1997 vs. 1996

Net sales increased $287 million due to volume gains and higher effective net pricing.

Salty snack kilos rose 11%, led by strong double-digit growth by Sabritas and our business in Brazil, while sweet snack kilos declined 5% due to a market contraction at Gamesa.

Reported operating profit decreased $28 million. Ongoing operating profit increased $34 million or 10%. Excluding foreign currency impact, ongoing operating profit increased 8%. This increase was due to volume gains partially offset by increased G&A. The higher effective net pricing was fully offset by inflation-driven higher operating and manufacturing costs, primarily in Mexico. Ongoing operating profit also benefited from the gain on the sale of a flour mill. The foreign currency impact resulted from the strength of the British pound at Walkers.

TROPICANA

From the date of acquisition in 1998, net sales were $722 million and operating profit was $40 million. The operating profit reflects the impact of fourth quarter increases in the cost of oranges in advance of related selling price increases.

CONSOLIDATED CASH FLOWS

1998 vs. 1997

Our 1998 consolidated cash and cash equivalents decreased $1.6 billion compared to a $1.6 billion increase in 1997. Excluding cash provided by discontinued operations in 1997, the decrease in cash and cash equivalents was $1.6 billion in 1998 compared with a $4.6 billion decrease in 1997. The change in cash flow primarily reflects net proceeds from issuance of debt and the liquidation of investment portfolios in 1998 compared to net debt repayments in 1997. These cash inflows were primarily used to fund acquisitions and investments in unconsolidated affiliates during the year.

The acquisitions and investments in unconsolidated affiliates include the purchases of Tropicana, the remaining ownership interest in various bottlers, TSSC and various other international salty snack food businesses.

1997 vs. 1996

Our 1997 consolidated cash and cash equivalents increased $1.6 billion over the prior year reflecting a significant increase in cash

provided by discontinued operations which was used to reduce debt, increase our investment portfolios and repurchase shares.

The net cash flow provided by discontinued operations increased $5.6 billion in 1997. The significant increase primarily reflects a $4.5 billion cash distribution received from TRICON just prior to the restaurant spin-off. In addition, the increase reflects after-tax cash proceeds of $1.0 billion associated with the sale of PFS and the non-core U.S. restaurant businesses, the effects of refranchising restaurants and other operating activities.

Share Repurchases

Our share repurchase activity was as follows:

(in millions)	1998	1997	1996
Cost	$2,230	$2,459	$1,651
Shares repurchased			
Number of shares	59.2	69.0	54.2
% of shares outstanding at beginning of year	3.9%	4.5%	3.4%

At December 26, 1998, 73.2 million shares remain available under the current repurchase authority granted by our Board of Directors.

LIQUIDITY AND CAPITAL RESOURCES

At the end of the third quarter, we completed the acquisitions of Tropicana for $3.3 billion in cash and TSSC for $270 million in cash. The purchase prices were largely funded by the issuance of one year notes and commercial paper resulting in an increase in short-term borrowings at year-end 1998.

We increased our revolving credit facilities by $2.0 billion to $4.75 billion from $2.75 billion at year-end 1997. These unused credit facilities exist largely to support issuances of short-term debt. The facilities are composed of $3.1 billion expiring March 1999 and $1.65 billion expiring March 2003. At year-end 1998, $1.65 billion of short-term borrowings were reclassified as long-term, reflecting our intent and ability, through the existence of the unused revolving credit facilities, to refinance these borrowings. Annually, these facilities can be extended an additional year upon the mutual consent of PepsiCo and the lending institutions.

As discussed in Management's Discussion and Analysis – Pending Transactions/Events, our Board of Directors approved a plan for the separation of PBG. As noted, an initial public offering is expected to be consummated in the second quarter of 1999 subject to market conditions and regulatory approvals. In February and March of 1999, PBG and its principal operating subsidiary, Bottling LLC incurred $6.55 billion of indebtedness, a large portion of which is intended to be temporary and be repaid with the proceeds of the Offering. It is intended that the remainder will be carried as PBG's long-term indebtedness of which $2.3 billion is unconditionally guaranteed by PepsiCo. A substantial portion of the debt proceeds obtained by PBG was used to settle pre-existing intercompany amounts due to us. We plan to use these proceeds for general corporate purposes, including the repayment of a portion of our short-term borrowings.

As noted earlier in the discussion regarding pending transactions, as part of our agreement with Whitman to realign bottling territories, certain indebtedness associated with our transferred U.S. operations is planned to be assumed by new Whitman with net proceeds to us of $300 million.

Capital spending is expected to decline in 1999 to approximately $1.2 billion as we will no longer directly fund the capital spending related to PBG after the Offering. The decline will be offset, in part, by continued investment in other international bottling operations and in Frito-Lay International and full year capital spending in Tropicana.

Our strong cash-generating capability and financial condition give us ready access to capital markets throughout the world.

Consolidated Statement of Income

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	1998	1997	1996
Net Sales	$22,348	$20,917	$20,337
Costs and Expenses, net			
Cost of sales	9,330	8,525	8,452
Selling, general and administrative expenses	9,924	9,241	9,063
Amortization of intangible assets	222	199	206
Unusual impairment and other items	288	290	576
Operating Profit	2,584	2,662	2,040
Interest expense	(395)	(478)	(565)
Interest income	74	125	91
Income from Continuing Operations Before Income Taxes	2,263	2,309	1,566
Provision for Income Taxes	270	818	624
Income from Continuing Operations	1,993	1,491	942
Income from Discontinued Operations, net of tax	–	651	207
Net Income	$ 1,993	$ 2,142	$ 1,149
Income Per Share – Basic			
Continuing Operations	$ 1.35	$ 0.98	$ 0.60
Discontinued Operations	–	0.42	0.13
Net Income	$ 1.35	$ 1.40	$ 0.73
Average shares outstanding	1,480	1,528	1,564
Income Per Share – Assuming Dilution			
Continuing Operations	$ 1.31	$ 0.95	$ 0.59
Discontinued Operations	–	0.41	0.13
Net Income	$ 1.31	$ 1.36	$ 0.72
Average shares outstanding	1,519	1,570	1,606

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

(in millions)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	1998	1997	1996
Operating Activities			
Income from continuing operations	$ 1,993	$ 1,491	$ 942
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and amortization	1,234	1,106	1,073
Noncash portion of 1998 tax benefit	(259)	–	–
Noncash portion of unusual impairment and other items	254	233	366
Deferred income taxes	150	51	160
Other noncash charges and credits, net	237	342	505
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable	(104)	(53)	(67)
Inventories	29	79	(97)
Prepaid expenses and other current assets	(12)	(56)	84
Accounts payable and other current liabilities	(195)	84	297
Income taxes payable	(116)	142	(71)
Net change in operating working capital	(398)	196	146
Net Cash Provided by Operating Activities	3,211	3,419	3,192
Investing Activities			
Capital spending	(1,405)	(1,506)	(1,630)
Acquisitions and investments in unconsolidated affiliates	(4,537)	(119)	(75)
Sales of businesses	17	221	43
Sales of property, plant and equipment	134	80	9
Short-term investments, by original maturity			
More than three months – purchases	(525)	(92)	(115)
More than three months – maturities	584	177	192
Three months or less, net	839	(735)	736
Other, net	(126)	(96)	(214)
Net Cash Used for Investing Activities	(5,019)	(2,070)	(1,054)
Financing Activities			
Proceeds from issuances of long-term debt	990	–	1,772
Payments of long-term debt	(2,277)	(1,875)	(1,432)
Short-term borrowings, by original maturity			
More than three months – proceeds	2,713	146	740
More than three months – payments	(417)	(177)	(1,873)
Three months or less, net	1,753	(1,269)	89
Cash dividends paid	(757)	(736)	(675)
Share repurchases	(2,230)	(2,459)	(1,651)
Proceeds from exercises of stock options	415	403	323
Other, net	–	5	(9)
Net Cash Provided by (Used for) Financing Activities	190	(5,962)	(2,716)
Net Cash Provided by Discontinued Operations	–	6,236	605
Effect of Exchange Rate Changes on Cash and Cash Equivalents	1	(2)	(5)
Net (Decrease) Increase in Cash and Cash Equivalents	(1,617)	1,621	22
Cash and Cash Equivalents – Beginning of Year	1,928	307	285
Cash and Cash Equivalents – End of Year	$ 311	$ 1,928	$ 307
Supplemental Cash Flow Information			
Interest paid	$ 367	$ 462	$ 538
Income taxes paid	$ 521	$ 696	$ 611
Schedule of Noncash Investing and Financing Activities			
Fair value of assets acquired	$ 5,359	$ 160	$ 81
Cash paid and stock issued	(4,537)	(134)	(76)
Liabilities assumed	$ 822	$ 26	$ 5

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

(in millions)
PepsiCo, Inc. and Subsidiaries
December 26, 1998 and December 27, 1997

	1998	1997
ASSETS		
Current Assets		
Cash and cash equivalents	$ 311	$ 1,928
Short-term investments, at cost	83	955
	394	2,883
Accounts and notes receivable, less allowance: $127 in 1998 and $125 in 1997	2,453	2,150
Inventories	1,016	732
Prepaid expenses, deferred income taxes and other current assets	499	486
Total Current Assets	4,362	6,251
Property, Plant and Equipment, net	7,318	6,261
Intangible Assets, net	8,996	5,855
Investments in Unconsolidated Affiliates	1,396	1,201
Other Assets	588	533
Total Assets	$22,660	$20,101
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 3,921	$ –
Accounts payable and other current liabilities	3,870	3,617
Income taxes payable	123	640
Total Current Liabilities	7,914	4,257
Long-Term Debt	4,028	4,946
Other Liabilities	2,314	2,265
Deferred Income Taxes	2,003	1,697
Shareholders' Equity		
Capital stock, par value 1 2/3¢ per share: authorized 3,600 shares, issued 1,726 shares	29	29
Capital in excess of par value	1,166	1,314
Retained earnings	12,800	11,567
Accumulated other comprehensive loss	(1,059)	(988)
	12,936	11,922
Less: Treasury stock, at cost: 255 shares and 224 shares in 1998 and 1997, respectively	(6,535)	(4,986)
Total Shareholders' Equity	6,401	6,936
Total Liabilities and Shareholders' Equity	$22,660	$20,101

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Shareholders' Equity

(in millions)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	Capital Stock				Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total
	Issued		Treasury					
	Shares	Amount	Shares	Amount				
Shareholders' Equity, December 30, 1995	1,726	$29	(150)	$(1,683)	$1,045	$ 8,730	$ (808)	$ 7,313
1996 Net income	–	–	–	–	–	1,149	–	1,149
Currency translation adjustment	–	–	–	–	–	–	40	40
Comprehensive income								1,189
Cash dividends declared	–	–	–	–	–	(695)	–	(695)
Share repurchases	–	–	(54)	(1,651)	–	–	–	(1,651)
Stock option exercises, including tax benefits of $145	–	–	23	310	158	–	–	468
Other	–	–	–	1	(2)	–	–	(1)
Shareholders' Equity, December 28, 1996	1,726	$29	(181)	$ (3,023)	$1,201	$ 9,184	$ (768)	$ 6,623
1997 Net income	–	–	–	–	–	2,142	–	2,142
Currency translation adjustment	–	–	–	–	–	–	(220)	(220)
Comprehensive income								1,922
Cash dividends declared	–	–	–	–	–	(746)	–	(746)
Share repurchases	–	–	(69)	(2,459)	–	–	–	(2,459)
Stock option exercises, including tax benefits of $173	–	–	25	488	88	–	–	576
Spin-off of restaurant businesses	–	–	–	–	–	987	–	987
Other	–	–	1	8	25	–	–	33
Shareholders' Equity, December 27, 1997	1,726	$29	(224)	$(4,986)	$1,314	$11,567	$ (988)	$ 6,936
1998 Net income	–	–	–	–	–	1,993	–	1,993
Currency translation adjustment	–	–	–	–	–	–	(75)	(75)
Reclassification adjustment	–	–	–	–	–	–	24	24
Total currency translation adjustment							(1,039)	
Minimum pension liability adjustment, net of tax benefits of $11	–	–	–	–	–	–	(20)	(20)
Comprehensive income								1,922
Cash dividends declared	–	–	–	–	–	(760)	–	(760)
Share repurchases	–	–	(59)	(2,230)	–	–	–	(2,230)
Stock option exercises, including tax benefits of $109	–	–	28	675	(151)	–	–	524
Other	–	–	–	6	3	–	–	9
Shareholders' Equity, December 26, 1998	1,726	$29	(255)	$(6,535)	$1,166	$12,800	$(1,059)	$ 6,401

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(tabular dollars in millions except per share amounts; all per share amounts assume dilution)

Note 1 – Summary of Significant Accounting Policies

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

Certain reclassifications were made to 1997 and 1996 amounts to conform with the 1998 presentation.

Principles of Consolidation

The financial statements include the consolidated accounts of PepsiCo, Inc. and its controlled affiliates. Intercompany balances and transactions have been eliminated. Investments in Unconsolidated Affiliates, over which we exercise significant influence but not control, are accounted for by the equity method. Our share of the net income or loss of such unconsolidated affiliates is included in selling, general and administrative expenses.

Revenue Recognition

We recognize revenue when products are delivered to customers. Sales terms generally do not allow a right to return.

Marketing Costs

Marketing costs are reported in selling, general and administrative expenses and include costs of advertising and other marketing activities. Advertising expenses were $1.9 billion in 1998 and $1.8 billion in both 1997 and 1996. Deferred advertising expense, classified as prepaid expenses in the Consolidated Balance Sheet, was $34 million in 1998 and $53 million in 1997. Deferred advertising costs are expensed in the year first used and consist of:

- media and personal service prepayments,
- promotional materials in inventory, and
- production costs of future media advertising.

Stock-Based Compensation

We measure stock-based compensation cost as the excess of the quoted market price of PepsiCo capital stock at the grant date over the amount the employee must pay for the stock (exercise price). Our policy is to generally grant stock options with an exercise price equal to the stock price at the date of grant and accordingly, no compensation cost is recognized.

Derivative Instruments

The interest differential to be paid or received on an interest rate swap is recognized as an adjustment to interest expense as the differential occurs. The interest differential not yet settled in cash is reflected in the Consolidated Balance Sheet as a receivable or payable under the appropriate current asset or liability caption. If an interest rate swap position were to be terminated, the gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt instrument it was intended to modify. However, if the underlying debt instrument were to be settled prior to maturity, the gain or loss realized upon termination would be recognized immediately.

The differential to be paid or received on a currency swap related to non-U.S. dollar denominated debt is charged or credited to income as the differential occurs. This is fully offset by the corresponding gain or loss recognized in income on the currency translation of the debt, as both amounts are based upon the same exchange rates. The currency differential not yet settled in cash is reflected in the Consolidated Balance Sheet under the appropriate current or noncurrent receivable or payable caption. If a currency swap position were to be terminated prior to maturity, the gain or loss realized upon termination would be immediately recognized in income.

Gains and losses on futures contracts designated as hedges of future commodity purchases are deferred and included in the cost of the hedged commodity when purchased. Changes in the value of such contracts used to hedge commodity purchases are highly correlated to the changes in the value of the purchased commodity. If the degree of correlation between the futures contracts and the purchased commodity were to significantly diminish during the contract term, subsequent changes in the value of the futures contracts would be recognized in income. If a futures contract were to be terminated, the gain or loss realized upon termination would be included in the cost of the hedged commodity when purchased.

Cash Equivalents

Cash equivalents represent funds temporarily invested, with maturities of three months or less. All other investment portfolios are primarily classified as short-term investments.

Inventories

Inventories are valued at the lower of cost (computed on the average, first-in, first-out or last-in, first-out method) or net realizable value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets.

Intangible Assets

Intangible assets are amortized on a straight-line basis over appropriate periods, generally ranging from 20 to 40 years.

Recoverability of Long-Lived Assets to be Held and Used in the Business

All long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impaired asset is written down to its estimated fair market value based on the best information available. Estimated fair market value is generally measured by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows.

Accounting and Reporting Changes

As of December 28, 1997, we adopted Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, issued by The American Institute of Certified Public Accountants in March 1998. The SOP requires capitalization of certain costs related to computer software developed or obtained for internal use which we had previously expensed in

selling, general and administrative expenses. The amount capitalized under the SOP in 1998 was $42 million.

As of December 28, 1997, we adopted Statement of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*, issued in June 1997. SFAS 130 requires the reporting and display of comprehensive income, which is composed of net income and other comprehensive income or loss items, in a full set of general purpose financial statements. Other comprehensive income or loss items are revenues, expenses, gains and losses that under generally accepted accounting principles are excluded from net income and reflected as a component of equity, such as currency translation and minimum pension liability adjustments.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 133 is effective for our fiscal year beginning 2000. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that we recognize all derivative instruments as either assets or liabilities in the Consolidated Balance Sheet and measure those instruments at fair value. We are currently assessing the effects of adopting SFAS 133, and have not yet made a determination of the impact adoption will have on our consolidated financial statements.

Note 2 – Acquisitions and Investments in Unconsolidated Affiliates

At the end of the third quarter in 1998, we completed the acquisitions of Tropicana Products, Inc. from The Seagram Company Ltd. for $3.3 billion in cash and The Smith's Snackfoods Company (TSSC) in Australia from United Biscuits Holdings plc for $270 million in cash. In addition, acquisitions and investments in unconsolidated affiliates included the remaining ownership interest in various bottlers and purchases of various other international salty snack food businesses. Acquisitions for the year aggregated $4.5 billion in cash. The results of operations of all acquisitions are generally included in the consolidated financial statements from their respective dates of acquisition. The acquisitions were accounted for under the purchase method and the purchase prices were largely funded by the issuance of one year notes and commercial paper. The purchase prices have been allocated based on the estimated fair value of the assets acquired and liabilities assumed. The excess purchase prices over the fair value of the net assets acquired of approximately $3.2 billion was allocated to goodwill and are amortized on a straight-line basis over 40 years.

The following table presents the unaudited pro forma combined results of PepsiCo and Tropicana as if the acquisition had occurred at the beginning of our fiscal years 1998 and 1997. The aggregate impact of other acquisitions in these periods was not material to our net sales, income or income per share from continuing operations.

	Unaudited	
	1998	1997
Net Sales	**$23,674**	$22,851
Income from Continuing Operations	**$ 1,939**	$ 1,427
Income Per Share from Continuing Operations	**$ 1.28**	$ 0.91

These pro forma amounts reflect the inclusion of the results of Tropicana for 1997 and the first three quarters of 1998 prior to the acquisition date as well as the results that are already included in the historical financial statements from the date of acquisition. In addition, the pro forma amounts include the amortization of the goodwill arising from the allocation of the purchase price and interest expense on the debt issued to finance the purchase. The pro forma information does not necessarily present what the combined results would have been for these periods and is not intended to be indicative of future results.

Note 3 – Impairment and Other Items Affecting Comparability of Income From Continuing Operations

Asset Impairment and Restructuring

	1998	1997	1996
Asset impairment charges			
Held and used in the business			
Property, plant and equipment	**$ 149**	$ 5	$ 8
Intangible assets	**37**	–	2
Investments in unconsolidated affiliates	**–**	–	190
Other assets	**14**	–	106
Held for disposal/abandonment			
Property, plant and equipment	**54**	111	–
Investments in unconsolidated affiliates	**–**	21	20
Net assets of business units	**–**	63	47
Total asset impairment	**254**	200	373
Restructuring charges			
Employee related costs	**24**	55	107
Other charges	**10**	35	96
Total unusual impairment and other items	**$ 288**	$ 290	$ 576
After-tax	**$ 261**	$ 239	$ 527
Per share	**$0.17**	$0.15	$0.33
Impairment by segment			
Pepsi-Cola North America	**$ –**	$ 52	$ –
Pepsi-Cola International	**200**	110	373
Frito-Lay North America	**54**	8	–
Frito-Lay International	**–**	30	–
	$ 254	$ 200	$ 373

The 1998 asset impairment and restructuring charges of $288 million are comprised of the following:

- A fourth quarter charge of $218 million for asset impairment of $200 million and restructuring charges of $18 million related to our Russian bottling operations. The economic turmoil in Russia which accompanied the August 1998 devaluation of the ruble had an adverse impact on our operations. Consequently, in our fourth quarter we experienced a significant drop in demand, resulting in lower net sales and increased operating losses. Also, since net bottling sales in Russia are denominated in rubles, whereas a substantial portion of our related costs and expenses are denominated in U.S. dollars, bottling operating margins were further eroded. In response to these conditions, we have reduced our cost structure primarily through closing facilities, renegotiating manufacturing contracts and reducing the number of employees. We also evaluated our long-lived bottling assets for impairment, triggered by the reduction in utilization of assets caused by the lower demand, the adverse change in the business climate and the expected continuation of operating losses and cash deficits in that market. The impairment charge reduced the net book value of the assets to their estimated fair market value, based primarily on amounts recently paid for similar assets in that marketplace. Of the total charge of $218 million, $212 million relates to bottling operations that will be part of The Pepsi Bottling Group, Inc. (see Note 18).
- An impairment charge of $54 million related to manufacturing equipment at Frito-Lay North America. In the fourth quarter, as part of our annual assessment of marketing plans and related capacity requirements at Frito-Lay North America and the development of a program to improve manufacturing productivity, we determined that certain product specific equipment would not be utilized and certain capital projects would be terminated to avoid production redundancies. The charge primarily reflects the write off of the net book value of the equipment and related projects. Disposal or abandonment of these assets will be substantially completed in the first quarter of 1999. See Note 18 for a discussion of future charges related to this program.
- A fourth quarter charge of $16 million for employee related costs resulting from the separation of Pepsi-Cola North America's concentrate and bottling organizations to more effectively serve retail customers in light of the expected conversion of PBG to public ownership (see Note 18). Of this amount, $10 million relates to bottling operations that will be part of PBG.

The employee related costs for 1998 of $24 million primarily include severance and relocation costs for approximately 2,700 employees located in the Russia bottling operations and at Pepsi-Cola North America field locations. Terminations of employees, which were communicated during the fourth quarter of 1998, have either occurred or will generally occur in the first half of 1999. Most amounts have been paid or will be paid in 1999.

In 1997 and 1996, asset impairment and restructuring charges reflected strategic decisions to realign the international bottling system, improve Frito-Lay International operating productivity and exit certain businesses. The impairment of assets to be held and used reflected reductions in forecasted cash flows attributable to increased competitive activity and weakened macro-economic factors in various geographic regions. The restructuring charges were primarily employee related severance which was substantially paid in 1997. The 1997 restructuring charges included proceeds of $87 million associated with a settlement related to a previous Venezuelan bottler agreement, partially offset by related costs.

At year-end 1998, the remaining 1997 and 1996 restructuring charges included in accounts payable and other current liabilities primarily relate to liabilities associated with investments in unconsolidated affiliates for which settlement is expected in 1999.

Income Tax Benefit

In 1998 we reported a tax benefit, included in the provision for income taxes, of $494 million (or $0.32 per share) as a result of reaching a final agreement with the Internal Revenue Service to settle substantially all remaining aspects of a tax case relating to our concentrate operations in Puerto Rico.

Note 4 – Discontinued Operations

The restaurants segment was composed of the core restaurant businesses of Pizza Hut, Taco Bell and Kentucky Fried Chicken, PepsiCo Food Systems, a restaurant distribution operation, and several non-core U.S. restaurant businesses. In 1997, we spun off the restaurant businesses to our shareholders as an independent publicly traded company (Distribution). The spin-off was effective as a tax-free Distribution on October 6, 1997 (Distribution Date). Owners of PepsiCo capital stock as of September 19, 1997 received one share of common stock of TRICON Global Restaurants, Inc., the new company, for every ten shares of PepsiCo capital stock. Immediately before the Distribution Date, we received $4.5 billion in cash from TRICON as repayment of certain amounts due and a dividend. PFS and the non-core U.S. restaurant businesses were sold before the Distribution Date resulting in after-tax cash proceeds of approximately $1.0 billion.

Income from discontinued operations:

	1997	1996
Net sales	$ 8,375	$ 11,441
Costs and expenses	(7,704)	(10,935)
PFS gain	500	–
Interest expense, net	(20)	(25)
Provision for income taxes	(500)	(274)
Income from discontinued operations	$ 651	$ 207

The above amounts include costs directly associated with the spin-off but do not include an allocation of our interest or general and administrative expenses.

Note 5 – Income Per Share

We present two income per share measures, basic and assuming dilution, on the face of the Consolidated Statement of Income. "Basic" income per share equals net income divided by weighted average common shares outstanding during the period. Income per share "assuming dilution" equals net income divided by the sum of weighted average common shares outstanding during the period plus common stock equivalents, such as stock options.

The following reconciles shares outstanding at the beginning of the year to average shares outstanding:

	1998	1997	1996
Shares outstanding at beginning of year	1,502	1,545	1,576
Weighted average shares issued during the year for exercise of stock options	18	14	13
Weighted average shares repurchased	(40)	(31)	(25)
Average shares outstanding – basic	1,480	1,528	1,564
Effect of dilutive securities			
Dilutive shares contingently issuable upon the exercise of stock options	144	151	169
Shares assumed to have been purchased for treasury with assumed proceeds from the exercise of stock options	(105)	(109)	(127)
Average shares outstanding – assuming dilution	1,519	1,570	1,606

Note 6 – Inventories

	1998	1997
Raw materials and supplies	$ 506	$398
Work-in-process	70	2
Finished goods	440	332
	$1,016	$732

The cost of 36% of 1998 inventories and 43% of 1997 inventories was computed using the last-in, first-out method.

Note 7 – Property, Plant and Equipment, net

	1998	1997
Land	$ 460	$ 365
Buildings and improvements	3,114	2,623
Machinery and equipment	8,806	7,513
Construction in progress	730	793
	13,110	11,294
Accumulated depreciation	(5,792)	(5,033)
	$ 7,318	$ 6,261

Note 8 – Intangible Assets, net

	1998	1997
Goodwill	$ 5,131	$ 2,298
Reacquired franchise rights	3,118	2,860
Trademarks and other identifiable intangibles	747	697
	$ 8,996	$ 5,855

Identifiable intangible assets possess economic value but lack physical substance. These assets primarily arise from the allocation of purchase prices of businesses acquired. Amounts assigned to such identifiable intangibles are based on independent appraisals or internal estimates. Goodwill represents the residual purchase price after allocation to all identifiable net assets (see Note 2).

The above amounts are presented net of accumulated amortization of $1.9 billion at year-end 1998 and $1.7 billion at year-end 1997.

Note 9 – Accounts Payable and Other Current Liabilities

	1998	1997
Accounts payable	$ 1,180	$ 1,047
Accrued compensation and benefits	676	640
Accrued selling and marketing	596	485
Other current liabilities	1,418	1,445
	$ 3,870	$ 3,617

Note 10 – Short-Term Borrowings and Long-Term Debt

	1998	1997
Short-Term Borrowings		
Commercial paper (5.3%)	$ 1,901	$ –
Current maturities of long-term debt	1,075	1,819
Notes (5.2% and 5.7%)	2,076	80
Other borrowings (7.4% and 7.4%)	519	222
Amount reclassified to long-term debt	(1,650)	(2,121)
	$ 3,921	$ –
Long-Term Debt		
Short-term borrowings, reclassified	$ 1,650	$ 2,121
Notes due 1999-2013 (5.8% and 6.4%)	1,693	3,063
Various foreign currency debt, due 1999-2001 (5.3% and 5.2%)	956	809
Zero coupon notes, $1.0 billion due 1999-2012 (10.1% and 10.5%)	504	480
Other, due 1999-2014 (6.8% and 7.2%)	300	292
	5,103	6,765
Less current maturities of long-term debt	(1,075)	(1,819)
	$ 4,028	$ 4,946

The interest rates in the above table include the effects of associated interest rate and currency swaps at year-end 1998 and 1997. Also, see Note 11 for a discussion of our use of interest rate and currency swaps, our management of the inherent credit risk and fair value information related to debt and interest rate and currency swaps.

Interest Rate Swaps

The following table indicates the notional amount and weighted average interest rates, by category, of interest rate swaps outstanding at year-end 1998 and 1997. The weighted average variable interest rates that we pay, which are primarily linked to either commercial paper or LIBOR rates, are based on rates as of the respective balance sheet date and are subject to change. The terms of the interest rate swaps match the terms of the debt they modify. The swaps terminate at various dates through 2013.

	1998	1997
Receive fixed-pay variable		
Notional amount	$1,855	$2,584
Weighted average receive rate	6.1%	6.8%
Weighted average pay rate	5.3%	5.8%
Receive variable-pay variable		
Notional amount	$ –	$ 250
Weighted average receive rate	–	5.7%
Weighted average pay rate	–	5.8%
Receive variable-pay fixed		
Notional amount	$ –	$ 215
Weighted average receive rate	–	5.9%
Weighted average pay rate	–	8.2%

At year-end 1998, approximately 83% of total debt was exposed to variable interest rates, compared to 77% in 1997. In addition to variable rate long-term debt, all debt with maturities of less than one year is categorized as variable for purposes of this measure.

Currency Swaps

We enter into currency swaps to hedge our currency exposure on certain non-U.S. dollar denominated debt. At year-end 1998, the aggregate carrying amount of the debt was $678 million and the net receivables and payables under related currency swaps were $1 million and $70 million, respectively, resulting in a net effective U.S. dollar liability of $747 million with a weighted average interest rate of 5.3%, including the effects of related interest rate swaps. At year-end 1997, the carrying amount of this debt aggregated $629 million and the net payables under related currency swaps aggregated $104 million, resulting in an effective U.S. dollar liability of $733 million with a weighted average interest rate of 5.8%, including the effects of related interest rate swaps.

Revolving Credit Facilities

We increased our 1998 unused revolving credit facility by $2.0 billion to $4.75 billion from $2.75 billion at year-end 1997. These unused credit facilities exist largely to support the issuances of short-term borrowings and are available for general corporate purposes. The 1998 facilities are composed of $3.1 billion expiring March 1999 and $1.65 billion expiring March 2003.

Short-term borrowings of $1.65 billion at year-end 1998 and $2.1 billion at year-end 1997 were reclassified as long-term debt. This reflects our intent and ability, through the existence of the unused credit facilities, to refinance these borrowings.

Long-term debt outstanding at December 26, 1998 matures as follows during the next five years:

	1999	2000	2001	2002	2003
Maturities	$1,075	$716	$323	$36	$284

Note 11 – Financial Instruments

Derivative Instruments

Our policy prohibits the use of derivative instruments for speculative purposes and we have procedures in place to monitor and control their use. The following discussion excludes future contracts to hedge immaterial amounts of our commodity purchases.

Our use of derivative instruments is primarily limited to interest rate and currency swaps, which are used to reduce borrowing costs by effectively modifying the interest rate and currency of specific debt issuances. These swaps are entered into concurrently with the issuance of the debt they are intended to modify. The notional amount, interest payment and maturity dates of the swaps match the principal, interest payment and maturity dates of the related debt. Accordingly, any market risk or opportunity associated with these swaps is fully offset by the opposite market impact on the related debt. Our credit risk related to interest rate and currency swaps is considered low because such swaps are entered into only with strong creditworthy counterparties, are generally settled on a net basis and are of relatively short duration. Further, there is no concentration with counterparties. See Note 10 for the notional amounts, related interest rates and maturities of the interest rate and currency swaps. See Management's Discussion and Analysis – Market Risk beginning on page 13.

Fair Value

Carrying amounts and fair values of our financial instruments:

	1998		1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and cash equivalents	$ 311	$ 311	$1,928	$1,928
Short-term investments	$ 83	$ 83	$ 955	$ 955
Other assets (noncurrent investments)	$ 5	$ 5	$ 15	$ 15
Liabilities				
Debt				
Short-term borrowings and long-term debt, net of capital leases	$7,934	$8,192	$4,909	$5,124
Debt-related derivative instruments				
Open contracts in asset position	(6)	(20)	(28)	(22)
Open contracts in liability position	72	57	107	109
Net debt	$8,000	$8,229	$4,988	$5,211

The above carrying amounts are included in the Consolidated Balance Sheet under the indicated captions, except for debt-related

derivative instruments (interest rate and currency swaps), which are included in the appropriate current or noncurrent asset or liability caption. Short-term investments consist primarily of debt securities and have been classified as held-to-maturity. Noncurrent investments mature at various dates through 2000.

Because of the short maturity of cash equivalents and short-term investments, the carrying amounts approximate fair value. The fair value of noncurrent investments is based upon market quotes. The fair value of debt and debt-related derivative instruments was estimated using market quotes and calculations based on market rates.

Note 12 – Income Taxes

U.S. and foreign income from continuing operations before income taxes:

	1998	1997	1996
U.S.	$1,629	$1,731	$1,630
Foreign	634	578	(64)
	$2,263	$2,309	$1,566

Provision for income taxes on income from continuing operations:

		1998	1997	1996
Current:	Federal	$ (193)	$ 598	$ 254
	Foreign	267	110	138
	State	46	59	72
		120	767	464
Deferred:	Federal	136	23	204
	Foreign	4	15	(41)
	State	10	13	(3)
		150	51	160
		$ 270	$ 818	$ 624

Reconciliation of the U.S. Federal statutory tax rate to our effective tax rate on continuing operations:

	1998	1997	1996
U.S. Federal statutory tax rate	35.0%	35.0%	35.0%
State income tax, net of Federal tax benefit	1.6	2.0	2.9
Effect of lower taxes on foreign results	(3.0)	(5.5)	(4.4)
Settlement of prior years' audit issues	(5.7)	(1.7)	(2.9)
Puerto Rico settlement	(21.8)	–	–
Effect of unusual impairment and other items	3.4	2.2	9.7
Other, net	2.4	3.4	(0.5)
Effective tax rate on continuing operations	11.9%	35.4%	39.8%

In 1998, we reached final agreement with the IRS to settle substantially all remaining aspects of a tax case related to our concentrate operations in Puerto Rico. As a result, we recognized a tax benefit totaling $494 million (or $0.32 per share) which reduced our 1998 provision for income taxes.

Deferred taxes are recorded to give recognition to temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. We record the tax effect of the temporary differences as deferred tax assets or deferred tax liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future years. Deferred tax liabilities generally represent items that we have taken a tax deduction for, but have not yet recorded in the income statement.

Deferred tax liabilities (assets):

	1998	1997
Intangible assets other than nondeductible goodwill	$ 1,444	$ 1,363
Property, plant and equipment	665	500
Safe harbor leases	109	115
Zero coupon notes	79	84
Other	473	335
Gross deferred tax liabilities	2,770	2,397
Net operating loss carryforwards	(562)	(520)
Postretirement benefits	(246)	(247)
Various current liabilities and other	(702)	(510)
Gross deferred tax assets	(1,510)	(1,277)
Deferred tax assets valuation allowance	571	458
Net deferred tax assets	(939)	(819)
Net deferred tax liabilities	$ 1,831	$ 1,578
Included in:		
Prepaid expenses, deferred income taxes and other current assets	$ (172)	$ (119)
Deferred income taxes	2,003	1,697
	$ 1,831	$ 1,578

Deferred tax liabilities are not recognized for temporary differences related to investments in foreign subsidiaries and in unconsolidated foreign affiliates that are essentially permanent in duration. It would not be practicable to determine the amount of any such deferred tax liabilities.

Net operating losses of $2.7 billion at year-end 1998 were carried forward and are available to reduce future taxable income of certain subsidiaries in a number of foreign and state jurisdictions. These net operating losses will expire as follows: $96 million in 1999, $2.4 billion between 2000 and 2012, while $201 million may be carried forward indefinitely.

Note 13 – Employee Stock Options

Stock options have been granted to employees under three different incentive plans:

- the SharePower Stock Option Plan (SharePower),
- the Long-Term Incentive Plan (LTIP) and
- the Stock Option Incentive Plan (SOIP).

SharePower

SharePower stock options are granted to essentially all full-time employees. SharePower options have a 10 year term. Prior to 1998, the number of options granted was based on each employee's annual earnings and generally became exercisable ratably over 5 years. In 1998, the number of SharePower options granted was based on earnings and tenure and generally become exercisable after 3 years.

SOIP and LTIP Prior to 1998

Prior to 1998, SOIP options were granted to middle management employees and were exercisable after 1 year. LTIP options were granted to senior management employees and were generally exercisable after 4 years. Both SOIP and LTIP options have 10 year terms. Certain LTIP options could be exchanged by employees for a specified number of performance share units (PSUs) within 60 days of the grant date. The value of a PSU was fixed at the stock price at the grant date and the PSU was payable 4 years from the grant date, contingent upon attainment of prescribed performance goals. At year-end 1998, 1997 and 1996, there were 84,000, 801,000 and 763,000 PSUs outstanding, respectively. Payment of PSUs is made in cash and/or stock as approved by the Compensation Committee of our Board of Directors. Amounts expensed in continuing operations for PSUs were $1 million in 1998 and $4 million in both 1997 and 1996.

SOIP and LTIP in 1998

Beginning in 1998, all executive (including middle management) awards are made under the LTIP. Under the LTIP, an executive receives an award based on a multiple of base salary. Two-thirds of the award consists of stock options with an exercise price equal to the stock price at the date of the award. These options become exercisable at the end of 3 years and have a 10 year term.

At the executive's discretion at the date of the award, the remaining one-third of the award will be granted in stock options at the end of 3 years or paid in cash at the end of 3 years. The number of options granted or the cash payment, if any, will depend on the attainment of prescribed performance goals over the 3 year period. If the executive chooses stock options, they are granted with an exercise price equal to the stock price at the date of the grant, vest immediately and have a 10 year term. If the executive chooses a cash payment, one dollar of cash will be received for every four dollars of the award. Amounts expensed for expected cash payments were $7 million in 1998. At year-end 1998, 162 million shares were available for grants under the LTIP.

Stock option activity:

(Options in thousands)	1998		1997		1996	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	146,329	$18.95	177,217	$20.22	160,662	$16.10
Granted	34,906	36.33	3,457	31.54	51,305	31.19
Exercised	(28,076)	15.31	(25,504)	15.77	(22,687)	14.19
Surrendered for PSUs	(24)	37.46	(15)	37.68	(431)	29.91
Forfeited	(6,144)	28.83	(7,819)	24.89	(11,632)	23.13
Spin-off related:						
Conversion to TRICON options (a)	–	–	(13,267)	25.75	–	–
PepsiCo modification (b)	–	–	12,260	–	–	–
Outstanding at end of year	146,991	23.28	146,329	18.95	177,217	20.22
Exercisable at end of year	82,692	16.74	81,447	15.39	80,482	14.92
Weighted average fair value of options granted during the year		$9.82		$10.55		$8.89

(a) Effective on the date of the TRICON spin-off, unvested PepsiCo capital stock options held by TRICON employees were converted to TRICON stock options.

(b) Immediately following the spin-off, the number of options were increased and exercise prices were decreased (the "modification") to preserve the economic value of those options that existed just prior to the spin-off for the holders of PepsiCo capital stock options.

Stock options outstanding and exercisable at December 26, 1998:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
$ 4.25 to $ 9.84	11,469	1.39 yrs.	$ 7.43	11,449	$ 7.45
$11.12 to $23.78	69,021	4.49	16.87	63,449	16.70
$26.04 to $41.50	66,501	8.27	32.80	7,794	30.53
	146,991	5.85	23.28	82,692	16.74

Pro forma income and pro forma income per share, as if we had recorded compensation expense based on fair value for stock-based awards:

	1998	1997	1996
Reported			
Income			
Continuing operations	$1,993	$1,491	$ 942
Discontinued operations	–	651	207
Net income	$1,993	$2,142	$1,149
Income per share			
Continuing operations	$ 1.31	$ 0.95	$ 0.59
Discontinued operations	–	0.41	0.13
Net income	$ 1.31	$ 1.36	$ 0.72
Pro Forma			
Income			
Continuing operations	$1,888	$1,390	$ 893
Discontinued operations	–	635	188
Net income	$1,888	$2,025	$1,081
Income per share			
Continuing operations	$ 1.24	$ 0.89	$ 0.55
Discontinued operations	–	0.40	0.12
Net income	$ 1.24	$ 1.29	$ 0.67

Without the effect of pro forma costs related to the modification of outstanding options arising from the TRICON spin-off, pro forma income from continuing operations is $1,899 million or $1.25 per share in 1998 and $1,436 million or $0.92 per share in 1997.

The pro forma amounts disclosed above are not fully representative of the effects of stock-based awards because, except for the impact resulting from the TRICON modification, the amounts exclude the pro forma cost related to the unvested stock options granted before 1995.

The fair value of the options granted (including the modification) is estimated using the Black-Scholes option-pricing model based on the following weighted average assumptions:

	1998	1997	1996
Risk free interest rate	4.7%	5.8%	6.0%
Expected life	5 years	3 years	6 years
Expected volatility	23%	20%	20%
Expected dividend yield	1.14%	1.32%	1.5%

Note 14 – Pension and Postretirement Benefits

In 1998, we adopted the revised disclosure requirements of Statement of Financial Accounting Standards No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits.* SFAS 132 standardized the disclosures of pensions and other postretirement benefits into a combined format but did not change the accounting for these benefits. Prior years' information has been reclassified to conform to the 1998 disclosure format.

Pension Benefits

Our pension plans cover substantially all full-time U.S. employees and certain international employees. Benefits depend on years of service and earnings or are based on stated amounts for each year of service.

Postretirement Benefits

Our postretirement plans provide medical and life insurance benefits principally to U.S. retirees and their dependents. Employees are eligible for benefits if they meet age and service requirements and qualify for retirement benefits.

Components of net periodic benefit cost:

	Pension		
	1998	1997	1996
Service cost	$ 95	$ 82	$ 74
Interest cost	136	123	111
Expected return on plan assets	(169)	(148)	(136)
Amortization of transition asset	(9)	(14)	(14)
Amortization of prior service amendments	12	11	10
Amortization of net loss	5	4	2
Net periodic benefit cost	$ 70	$ 58	$ 47
Settlement loss/(gain)	9	(4)	–
Special termination benefits	4	8	–
Net periodic benefit cost including settlements and special termination benefits	$ 83	$ 62	$ 47

Components of net periodic benefit cost:

	Postretirement		
	1998	1997	1996
Service cost	$ 16	$ 12	$ 12
Interest cost	39	40	43
Amortization of prior service amendments	(18)	(18)	(18)
Amortization of net (gain)/loss	(2)	–	2
Net periodic benefit cost	$ 35	$ 34	$ 39
Special termination benefits	1	–	–
Net periodic benefit cost including special termination benefits	$ 36	$ 34	$ 39

Prior service costs are amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits.

Change in the benefit obligation:

	Pension		Postretirement	
	1998	1997	1998	1997
Obligation at beginning of year	$ 1,928	$1,672	$ 528	$ 525
Service cost	95	82	16	12
Interest cost	136	123	39	40
Plan amendments	5	11	–	–
Participant contributions	4	3	–	–
Actuarial loss/(gain)	229	153	56	(13)
Acquisitions/(divestitures)	236	(16)	42	(5)
Benefit payments	(149)	(99)	(38)	(31)
Curtailment gain	(1)	(1)	–	–
Special termination benefits	4	8	1	–
Foreign currency adjustment	(8)	(8)	–	–
Obligation at end of year	$ 2,479	$1,928	$ 644	$ 528

Change in the fair value of plan assets:

	Pension		Postretirement	
	1998	1997	1998	1997
Fair value at beginning of year	$ 1,997	$1,638	$ –	$ –
Actual return on plan assets	(71)	439	–	–
Acquisitions/(divestitures)	240	(5)	–	–
Employer contributions	31	29	38	31
Participant contributions	4	3	–	–
Benefit payments	(149)	(99)	(38)	(31)
Foreign currency adjustment	(7)	(8)	–	–
Fair value at end of year	$ 2,045	$1,997	$ –	$ –

Selected information for plans with accumulated benefit obligation in excess of plan assets:

	Pension		Postretirement	
	1998	1997	1998	1997
Projected benefit obligation	$(1,960)	$ (161)	$(644)	$(528)
Accumulated benefit obligation	$(1,661)	$ (83)	$(644)	$(528)
Fair value of plan assets	$ 1,498	$ 14	–	–

Funded status as recognized on the Consolidated Balance Sheet:

	Pension		Postretirement	
	1998	1997	1998	1997
Funded status at end of year	$ (434)	$ 69	$(644)	$(528)
Unrecognized prior service cost	76	83	(69)	(87)
Unrecognized loss/(gain)	338	(122)	29	(29)
Unrecognized transition asset	(7)	(16)	–	–
Net amounts recognized	$ (27)	$ 14	$(684)	$(644)

Net amounts as recognized in the Consolidated Balance Sheet:

	Pension		Postretirement	
	1998	1997	1998	1997
Prepaid benefit cost	$ 116	$ 137	$ –	$ –
Accrued benefit liability	(210)	(123)	(684)	(644)
Intangible assets	36	–	–	–
Accumulated other comprehensive income	31	–	–	–
Net amounts recognized	$ (27)	$ 14	$(684)	$(644)

Weighted-average assumptions at end of year:

	Pension		
	1998	1997	1996
Discount rate for benefit obligation	6.8%	7.3%	7.8%
Expected return on plan assets	10.2%	10.3%	10.3%
Rate of compensation increase	4.7%	4.8%	4.8%

The discount rate assumptions used to compute the postretirement benefit obligation at year-end were 6.9% in 1998 and 7.4% in 1997.

Components of Pension Assets

The pension plan assets are principally stocks and bonds. The U.S. plan held approximately 10.1 million shares of PepsiCo capital stock with a fair value of $298 million in 1998 and 11.7 million shares with a fair value of $436 million in 1997. The plan received dividends on PepsiCo capital stock of $6 million in both 1998 and 1997. To maintain diversification, 1.6 million shares of PepsiCo capital stock were sold in 1998 and .5 million shares were sold in 1997.

Health Care Cost Trend Rates

An average increase of 6.7% in the cost of covered postretirement medical benefits is assumed for 1999 for employees who retired before cost sharing was introduced. This average increase is then projected to decline gradually to 5.5% in 2005 and thereafter.

An average increase of 6.5% in the cost of covered postretirement medical benefits is assumed for 1999 for employees who retired after cost sharing was introduced. This average increase is then projected to decline gradually to zero in 2005 and thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for postretirement medical plans. A one percentage point change in assumed health care costs would have the following effects:

	1% Increase	1% Decrease
Effect on total of 1998 service and interest cost components	$ 2	$ (2)
Effect on the 1998 accumulated postretirement benefit obligation	$30	$(28)

Note 15 – Contingencies

We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. Contingent liabilities primarily reflect guarantees to support financial arrangements of certain unconsolidated affiliates. We believe that the ultimate liability, if any, in excess of amounts already recognized arising from such claims or contingencies is not likely to have a material adverse effect on our annual results of operations, financial condition or liquidity.

Note 16 – Business Segments

In 1998, we adopted Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of a Business Enterprise and Related Information,* which is generally based on our 1998 management reporting. The prior years' segment information presented in this footnote has been restated to present our five reportable segments as follows:

- Pepsi-Cola
  - North America
  - International
- Frito-Lay
  - North America
  - International
- Tropicana

The North American segments include the United States and Canada. The Tropicana segment includes its worldwide results. In contemplation of the proposed separation from PepsiCo of our bottling operation (see Note 18), we completed a reorganization of our Pepsi-Cola businesses in 1999. Our 1998 financial statements do not reflect the reorganization.

The accounting policies of the segments are the same as those described in Note 1 - Summary of Significant Accounting Policies. All intersegment net sales and expenses are immaterial and have been eliminated in computing net sales and operating profit.

Pepsi-Cola North America

Pepsi-Cola North America markets and distributes its Pepsi-Cola, Diet Pepsi, Mountain Dew and other brands. PCNA manufactures concentrates of its brands for sale to franchised bottlers. PCNA operates bottling plants and distribution facilities for the production and distribution of company-owned and licensed brands. PCNA also manufactures and distributes ready-to-drink Lipton tea products through a joint venture and processes and distributes Aquafina bottled water.

Investments in unconsolidated affiliates are primarily in franchised bottling and distribution operations.

Pepsi-Cola International

Pepsi-Cola International markets and distributes its Pepsi-Cola, Diet Pepsi, Mountain Dew, 7UP, Diet 7UP, Mirinda, Pepsi Max and other brands internationally. PCI manufactures concentrates of its brands for sale to franchised bottlers. PCI operates bottling plants and distribution facilities in various international markets for the production and distribution of company-owned and licensed brands.

Principal international markets include Argentina, Brazil, China, India, Mexico, the Philippines, Saudi Arabia, Spain, Thailand and the United Kingdom. Investments in unconsolidated affiliates are primarily in franchised bottling and distribution operations.

Frito-Lay North America

Frito-Lay North America primarily markets, manufactures and distributes salty snacks. Products manufactured and distributed in North America include Lay's and Ruffles brand potato chips, Doritos and Tostitos brand tortilla chips, Fritos brand corn chips, Cheetos brand cheese flavored snacks, Rold Gold brand pretzels, and a variety of dips and salsas. Low-fat and no-fat versions of several core brands are also manufactured and distributed in North America.

Frito-Lay International

Frito-Lay International markets, manufactures and distributes salty and sweet snacks. Products include Walkers brand snack foods in the United Kingdom, Sabritas brand snack foods in Mexico, and Alegro and Gamesa brand sweet snacks in Mexico. Many of our U.S. brands have been introduced internationally such as Lay's and Ruffles brand potato chips, Doritos and Tostitos brand tortilla chips, Fritos brand corn chips and Cheetos brand cheese flavored snacks.

Principal international snack markets include Australia, Brazil, Mexico, the Netherlands, South Africa, Spain and the United Kingdom.

Tropicana

Tropicana markets, produces and distributes its juices worldwide. Products include Tropicana Pure Premium, Season's Best, Dole, Tropicana Pure Tropics and Tropicana Twister brand juices primarily sold in the United States and many in Canada and brands such as Fruvita, Hitchcock, Looza and Copella available in Europe.

Principal international markets include Belgium, Canada, France and the United Kingdom. The investment in unconsolidated affiliates is a distribution operation.

Impairment and Other Items Affecting Comparability

Effects on segments of impairment and other items are as follows:

	1998	1997	1996
Pepsi-Cola			
– North America	$ 16	$ 52	$ –
– International	218	154	576
Frito-Lay			
– North America	54	22	–
– International	–	62	–
Combined Segments	$288	$290	$576

See Note 3 for details on the above unusual impairment and other items.

BUSINESS SEGMENTS

	1998	1997	1996
NET SALES			
Pepsi-Cola			
– North America	$ 8,266	$ 7,899	$ 7,788
– International	2,385	2,642	2,799
Frito-Lay			
– North America	7,474	6,967	6,628
– International	3,501	3,409	3,122
Tropicana	722	–	–
	$22,348	$20,917	$20,337
OPERATING PROFIT (a)			
Pepsi-Cola			
– North America	$ 1,211	$ 1,274	$ 1,428
– International	(219)	(144)	(846)
Frito-Lay			
– North America	1,424	1,388	1,286
– International	367	318	346
Tropicana	40	–	–
Combined Segments	2,823	2,836	2,214
Corporate (b)	(239)	(174)	(174)
	$ 2,584	$ 2,662	$ 2,040
Total Assets			
Pepsi-Cola			
– North America	$ 8,269	$ 7,562	$ 7,199
– International	2,536	3,134	3,487
Frito-Lay			
– North America	3,915	3,650	3,116
– International	4,039	3,583	3,418
Tropicana	3,661	–	–
Corporate (c)	240	2,172	490
Net Assets of Discontinued Operations	–	–	4,450
	$22,660	$20,101	$22,160
Amortization of Intangible Assets			
Pepsi-Cola			
– North America	$ 136	$ 141	$ 143
– International	14	14	22
Frito-Lay			
– North America	7	6	5
– International	43	38	36
Tropicana	22	–	–
	$ 222	$ 199	$ 206
Depreciation and Other Amortization Expense			
Pepsi-Cola			
– North America	$ 369	$ 337	$ 323
– International	140	166	191
Frito-Lay			
– North America	326	285	243
– International	142	112	103
Tropicana	27	–	–
Corporate	8	7	7
	$ 1,012	$ 907	$ 867

(a) Includes Impairment and Other Items Affecting Comparability on page 35.
(b) Includes unallocated corporate headquarters expenses and costs of centrally managed insurance programs, minority interests and foreign exchange translation and transaction gains and losses.
(c) Corporate assets consist principally of cash and cash equivalents, short-term investments primarily held outside the U.S. and property and equipment.

	1998	1997	1996
Significant Other Noncash Items (d)			
Pepsi-Cola			
– North America	$ –	$ 52	$ –
– International	200	119	366
Frito-Lay			
– North America	54	9	–
– International	–	53	–
	$ 254	$ 233	$ 366
Capital Spending			
Pepsi-Cola			
– North America	$ 472	$ 430	$ 399
– International	138	188	249
Frito-Lay			
– North America	402	622	760
– International	314	251	213
Tropicana	50	–	–
Corporate	29	15	9
	$ 1,405	$ 1,506	$ 1,630
Investments in Unconsolidated Affiliates			
Pepsi-Cola			
– North America	$ 326	$ 340	$ 308
– International	685	605	562
Frito-Lay			
– North America	–	–	3
– International	341	234	252
Tropicana	22	–	–
Corporate	22	22	22
	$ 1,396	$ 1,201	$ 1,147
Equity Income/(Loss) from Unconsolidated Affiliates (e)			
Pepsi-Cola			
– North America	$ 50	$ 41	$ 32
– International	(21)	(4)	(341)
Frito-Lay			
– North America	–	(3)	–
– International	(5)	50	35
Tropicana	1	–	–
	$ 25	$ 84	$ (274)
GEOGRAPHIC AREAS			
Net Sales			
United States	$15,381	$13,878	$13,408
International	6,967	7,039	6,929
Combined Segments	$22,348	$20,917	$20,337
Long-Lived Assets (f)			
United States	$12,948	$ 9,466	$ 9,271
International	4,762	3,851	3,998
Combined Segments	$17,710	$13,317	$13,269

(d) Represents the noncash portion of unusual items. See Note 3.
(e) Includes unusual charges of $256 million in 1996 in PCI related to the write down of our investment in Buenos Aires Embotelladora S.A. and our share of the unusual charges recorded by BAESA. In 1997, FLI included a gain of $22 million related to the sale of a non-core investment.
(f) Represents Property, Plant and Equipment, net, Intangible Assets, net and Investments in Unconsolidated Affiliates.

Note 17 – Selected Quarterly Financial Data

($ in millions except per share amounts, unaudited)

	First Quarter (12 Weeks)		Second Quarter (12 Weeks)		Third Quarter (12 Weeks)		Fourth Quarter (a) (16 Weeks)		Full Year (52 Weeks)	
	1998	1997	**1998**	1997	**1998**	1997	**1998**	1997	**1998**	1997
Net sales	**$ 4,353**	4,213	**$ 5,258**	5,086	**$ 5,544**	5,362	**$ 7,193**	6,256	**$ 22,348**	20,917
Gross profit	**$ 2,603**	2,492	**$ 3,110**	3,017	**$ 3,261**	3,183	**$ 4,044**	3,700	**$ 13,018**	12,392
Unusual impairment and other items – loss/(gain) [b]	**$ –**	(22)	**$ –**	326	**$ –**	–	**$ 288**	(14)	**$ 288**	290
Operating profit	**$ 590**	581	**$ 778**	436	**$ 889**	929	**$ 327**	716	**$ 2,584**	2,662
Income from continuing operations [c]	**$ 377**	318	**$ 494**	176	**$ 761**	551	**$ 361**	446	**$ 1,993**	1,491
Income (loss) from discontinued operations [d]	**$ –**	109	**$ –**	480	**$ –**	107	**$ –**	(45)	**$ –**	651
Net income	**$ 377**	427	**$ 494**	656	**$ 761**	658	**$ 361**	401	**$ 1,993**	2,142
Net income (loss) per share – basic										
Continuing operations	**$ 0.25**	0.21	**$ 0.33**	0.11	**$ 0.52**	0.36	**$ 0.25**	0.30	**$ 1.35**	0.98
Discontinued operations	**$ –**	0.07	**$ –**	0.31	**$ –**	0.07	**$ –**	(0.03)	**$ –**	0.42
Net income	**$ 0.25**	0.28	**$ 0.33**	0.42	**$ 0.52**	0.43	**$ 0.25**	0.27	**$ 1.35**	1.40
Net income (loss) per share – assuming dilution										
Continuing operations	**$ 0.24**	0.20	**$ 0.33**	0.11	**$ 0.50**	0.35	**$ 0.24**	0.29	**$ 1.31**	0.95
Discontinued operations	**$ –**	0.07	**$ –**	0.31	**$ –**	0.07	**$ –**	(0.04)	**$ –**	0.41
Net income	**$ 0.24**	0.27	**$ 0.33**	0.42	**$ 0.50**	0.42	**$ 0.24**	0.25	**$ 1.31**	1.36
Cash dividends declared per share	**$ 0.125**	0.115	**$ 0.13**	0.125	**$ 0.13**	0.125	**$ 0.13**	0.125	**$ 0.515**	0.49
Stock price per share [e]										
High	**$43 9/16**	34 55/64	**$44 11/16**	39	**$ 43 5/8**	39 11/16	**$ 41 1/16**	40	**$44 11/16**	40
Low	**$ 34 7/8**	29 1/8	**$ 37 5/8**	31 1/4	**$27 11/16**	35 1/2	**$28 11/16**	34 1/4	**$27 11/16**	29 1/8
Close	**$ 43**	32 1/2	**$40 11/16**	39	**$ 30 5/16**	37 5/8	**$ 40 7/16**	34 11/16	**$ 40 7/16**	34 11/16

(a) Fourth quarter 1998 includes the operating results of Tropicana which was acquired in August of 1998.

(b) Unusual impairment and other items – loss/(gain) (see Note 3):

	1998			1997		
	Pre-Tax	After-Tax	Per Share	Pre-Tax	After-Tax	Per Share
First quarter	$ –	$ –	$ –	$ (22)	$ 2	$ –
Second quarter	–	–	–	326	238	0.15
Fourth quarter	288	261	0.17	(14)	(1)	–
Full year	$ 288	$ 261	$ 0.17	$ 290	$ 239	$ 0.15

(c) Includes in 1998 a tax benefit of $200 million (or $0.13 per share) in the third quarter and $294 million (or $0.19 per share) in the fourth quarter. See Note 12.

(d) See Note 4.

(e) Represents the high, low and closing prices for one share of PepsiCo's capital stock on the New York Stock Exchange. Stock prices on or before October 6, 1997 are not adjusted to reflect the TRICON spin-off. See Note 4.

Note 18 – Pending Transactions/Events

In November 1998, our Board of Directors approved a plan for the separation from PepsiCo of certain wholly-owned bottling businesses located in the United States, Canada, Spain, Greece and Russia, referred to as The Pepsi Bottling Group. Pursuant to this plan, PBG intends to sell shares of its common stock in an initial public offering and PepsiCo intends to retain a noncontrolling ownership interest in PBG. A registration statement relating to the Offering was filed on Form S-1 with the Securities and Exchange Commission. The transaction is subject to market conditions and regulatory approval. If consummated, the transaction is expected to result in a gain to PepsiCo, net of related costs. These related costs will include a charge for the early vesting of PepsiCo stock options held by PBG employees, which will be based on the price of our stock at the date of the Offering. In February and March of 1999, PBG and its principal operating subsidiary, Bottling LLC, incurred $6.55 billion of indebtedness, a large portion of which is intended to be temporary and be repaid with the proceeds of the Offering. It is intended that the remainder will be carried as PBG's long-term indebtedness of which $2.3 billion is unconditionally guaranteed by PepsiCo.

In January 1999, we announced an agreement with the Whitman Corporation to realign bottling territories. Subject to approval by the Whitman shareholders and various regulatory authorities, we plan to combine certain of our bottling operations in the mid-western United States and Central Europe with most of Whitman's existing bottling businesses to create new Whitman. Under the terms of the agreement, our current equity interest of 20% in General Bottlers, the principal operating company of Whitman, will also be transferred to new Whitman. Whitman transferred its existing bottling operations in Marion, Virginia; Princeton, West Virginia; and St. Petersburg, Russia to PBG. It is planned for new Whitman to assume certain indebtedness associated with our transferred U.S. operations with net proceeds to us of $300 million. Upon completion of the transaction, we will receive 54 million shares of new Whitman common stock resulting in a noncontrolling ownership interest. If approved, this transaction is expected to result in a net gain to PepsiCo.

The Frito-Lay program, to improve productivity discussed in Note 3, also includes consolidating U.S. production in our most modern and efficient plants and streamlining logistics and transportation systems. This program is expected to result in additional asset impairment and restructuring charges of approximately $65 million to be recorded in the first quarter of 1999.

Management's Responsibility for Financial Statements

To Our Shareholders:

Management is responsible for the reliability of the consolidated financial statements and related notes. The financial statements were prepared in conformity with generally accepted accounting principles and include amounts based upon our estimates and assumptions, as required. The financial statements have been audited by our independent auditors, KPMG LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that our representations to the independent auditors were valid and appropriate.

Management maintains a system of internal controls designed to provide reasonable assurance as to the reliability of the financial statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. Our internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified. The Audit Committee of the Board of Directors, consists solely of directors, who are not salaried employees and who are, in the opinion of the Board of Directors, free from any relationship that would interfere with the exercise of independent judgment as a committee member. The Committee meets several times each year with representatives of management, including internal auditors and the independent accountants to review our financial reporting process and our controls to safeguard assets. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 26, 1998 provide reasonable assurance that the financial statements are reliable and that our assets are reasonably safeguarded.

Report of Independent Auditors

Board of Directors and Shareholders
PepsiCo, Inc.

We have audited the accompanying consolidated balance sheet of PepsiCo, Inc. and Subsidiaries as of December 26, 1998 and December 27, 1997 and the related consolidated statements of income, cash flows and shareholders' equity for each of the years in the three-year period ended December 26, 1998. These consolidated financial statements are the responsibility of PepsiCo, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PepsiCo, Inc. and Subsidiaries as of December 26, 1998 and December 27, 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 26, 1998, in conformity with generally accepted accounting principles.

KPMG LLP

KPMG LLP
New York, New York
February 1, 1999, except as to Note 18 which is as of March 8, 1999

Selected Financial Data

(in millions except per share and employee amounts, unaudited)
PepsiCo, Inc. and Subsidiaries

	Compounded Growth Rates 5-Year 1993-1998	1998[a][b]	1997[a]	1996[a]	1995[c]	1994[d][e][f]	1993
Summary of Operations							
Net sales	7%	$ 22,348	20,917	20,337	19,067	17,984	15,706
Operating profit	4%	$ 2,584	2,662	2,040	2,606	2,506	2,141
Income from continuing operations	12%	$ 1,993	1,491	942	1,422	1,363	1,152
Cash Flow Data							
Provided by operating activities		$ 3,211	3,419	3,192	2,642	NA	NA
Dividends paid	10%	$ 757	736	675	599	540	462
Share repurchases	37%	$ 2,230	2,459	1,651	541	549	463
Per Share Data							
Income from continuing operations – assuming dilution	13%	$ 1.31	0.95	0.59	0.88	0.85	0.71
Cash dividends declared	11%	$ 0.515	0.49	0.445	0.39	0.35	0.305
Book value per share at year-end	2%	$ 4.35	4.62	4.29	4.64	4.34	3.97
Market price per share at year-end (g)	14%	$40 7/16	34 11/16	29 5/8	27 15/16	18 1/8	20 15/16
Market price per share at year-end – continuing operations (h)	16%	$40 7/16	34 11/16	27 15/64	25 43/64	16 21/32	19 1/4
Balance Sheet							
Net assets of discontinued operations (i)		$ –	–	4,450	4,744	5,183	4,548
Total assets (j)		$ 22,660	20,101	22,160	22,944	22,533	21,628
Long-term debt		$ 4,028	4,946	8,174	8,248	8,570	7,148
Total debt (k)		$ 7,949	4,946	8,174	8,806	9,114	9,209
Shareholders' equity		$ 6,401	6,936	6,623	7,313	6,856	6,339
Other Statistics							
EBITDA from continuing operations (l)		$ 4,072	4,001	3,479	3,718	NA	NA
Return on invested capital (m)		16%	18	17	18	18	17
Number of shares repurchased		59.2	69.0	54.2	24.6	30.0	24.8
Shares outstanding at year-end		1,471	1,502	1,545	1,576	1,580	1,598
Average shares outstanding used to calculate income per share from continuing operations – assuming dilution		1,519	1,570	1,606	1,608	1,608	1,620
Employees of continuing operations		151,000	142,000	137,000	137,000	129,000	119,000

NA – Not Available

We made a significant acquisition in 1998 (see Note 2), numerous acquisitions in most years presented and a few divestitures in certain years. Such transactions do not materially affect the comparability of our operating results for the periods presented. In 1997, we disposed of our restaurants segment and accounted for it as discontinued operations (see Note 4). Accordingly, all information has been reclassified for the years 1997 and prior. All share and per share amounts reflect a two-for-one stock split in 1996 and per share amounts are computed using average shares outstanding, assuming dilution.

(a) Includes unusual impairment and other items of $288 ($261 after-tax or $0.17 per share) in 1998, $290 ($239 after-tax or $0.15 per share) in 1997 and $576 ($527 after-tax or $0.33 per share) in 1996. See Note 3.
(b) Includes a tax benefit of $494 (or $0.32 per share). See Note 12.
(c) Includes the initial, noncash charge of $66 ($64 after-tax or $0.04 per share) upon adoption in 1995 of Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.*
(d) Includes the cumulative effect of adopting SFAS 112, *Employers' Accounting for Postemployment Benefits* of $77 ($51 after-tax or $0.03 per share) and changing to a preferable method for calculating the market-related value of plan assets used in determining the return-on-asset component of annual pension expense and the cumulative net unrecognized gain or loss subject to amortization of $32 ($20 after-tax or $0.01 per share). Prior years were not restated for these changes in accounting.
(e) Includes a benefit of changing to the preferable method for calculating the market-related value of plan assets in 1994, which reduced full year pension expense by $29 ($18 after-tax or $0.01 per share).
(f) Fiscal year 1994 consists of 53 weeks. Normally, fiscal years consist of 52 weeks; however, because the fiscal year ends on the last Saturday in December, a week is added every 5 or 6 years. The fifty-third week increased 1994 earnings by approximately $31 ($28 after-tax or $0.02 per share).
(g) Represents historically reported market price of one share of PepsiCo capital stock.
(h) For 1996 and prior, represents approximately 92% of the historical market price of one share of PepsiCo capital stock, which is the allocated market value of our packaged goods businesses used by the NYSE on or before October 6, 1997. The remaining 8% represents the market value allocated to TRICON. See Note 4.
(i) Represents net assets of discontinued operations, which are included in total assets. See Note 4.
(j) Includes net assets of discontinued operations.
(k) Includes short-term borrowings and long-term debt.
(l) Defined as earnings before interest, taxes, depreciation, amortization and the noncash portion of unusual impairment and other items of $254 in 1998, $233 in 1997, $366 in 1996 and $66 in 1995. EBITDA is used by certain investors as a measure of a company's ability to service its debt. It should be considered in addition to, but not as a substitute for, other measures of financial performance in accordance with generally accepted accounting principles.
(m) Defined as income from continuing operations before after-tax interest expense, amortization of intangible assets, unusual impairment and other items and 1998 tax benefit divided by an average of the 5 most recent quarters net asset base before accumulated amortization of intangible assets and net asset base of discontinued operations. Return on invested capital is used by certain investors as a measure of a company's return on its investments. It should be considered in addition to, but not as a substitute for, other measures of financial performance in accordance with GAAP. In addition, our EBITDA may not be comparable to similar measures reported by other companies.

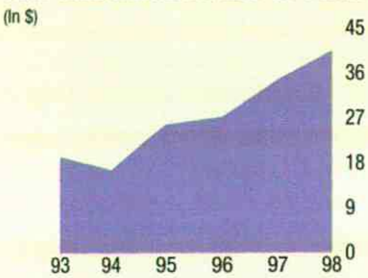
Stock Performance

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made on December 31,1993 was worth approximately $2,357 on December 31, 1998, assuming the reinvestment of dividends. This performance represents a compounded annual growth rate of 18.7%.

The closing price for a share of PepsiCo capital stock on the New York Stock Exchange was the price as reported by Bloomberg for the fiscal years ending 1993-1998, restated for the spin-off of the restaurant business.

Past performance is not necessarily indicative of future returns on investments in PepsiCo capital stock.

Year-end Market Price of Stock



Capital Stock Information

Stock Trading Symbol – PEP

Stock Exchange Listings

The New York Stock Exchange is the principal market for PepsiCo capital stock, which is also listed on the Amsterdam, Chicago, Swiss and Tokyo Stock Exchanges.

Shareholders

At year-end 1998, there were approximately 230,000 shareholders of record.

Dividend Policy

Quarterly cash dividends are usually declared in November, January, May and July and paid at the beginning of January and the end of March, June and September. The dividend record dates for 1999 are expected to be March 12, June 11, September 10 and December 10.

Quarterly cash dividends have been paid since PepsiCo was formed in 1965.

Cash Dividends Declared

Shareholder Information

Annual Meeting

The Annual Meeting of Shareholders will be held at PepsiCo World Headquarters on Anderson Hill Road, Purchase, New York at 11:00 a.m., Wednesday, May 5, 1999. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

Inquiries Regarding Your Stock Holdings

Registered Shareholders (shares held by you in your name) should address communications concerning statements, dividend payments, address changes, lost certificates and other administrative matters to:

The Bank of New York
Shareholder Services Dept.
P.O. Box 11258
Church Street Station
New York, NY 10286-1258
Telephone: (800) 226-0083
E-mail: shareowner-svcs@bankofny.com
Web site: http://stock.bankofny.com

or

Manager, Shareholder Relations
PepsiCo, Inc.
Purchase, NY 10577
Telephone: (914) 253-3055

In all correspondence or telephone inquires, please mention PepsiCo, your name as printed on your stock certificate, your Social Security number, your address and telephone number.

Beneficial Shareholders (shares held by your broker in the name of the brokerage house) should direct communications on all administrative matters to your stockbroker.

SharePower Participants (employees with SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower
Stock Option Plan Services
P.O. Box 30466
New Brunswick, NJ 08989
Telephone: (800) 637-6713 (U.S., Puerto Rico and Canada)
(732) 469-8877 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your Social Security number), your address, your telephone number and mention PepsiCo SharePower. For telephone inquiries, please have a copy of your most recent statement available.

Employee Benefit Plan Participants:

Capital Stock Purchase Plan	(800) 227-4015
SaveUp (formerly 401(k),	
Long Term Savings, ESOP)	(800) 227-4015
P.O. Box 9108	(617) 472-3127
Boston, MA 02209	(outside U.S.)

Please have a copy of your most recent statement available when calling with inquires.

Shareholder Services

Dividend Reinvestment Plan

A brochure explaining this convenient plan, for which PepsiCo pays all administrative costs, is available from our transfer agent:

The Bank of New York
Dividend Reinvestment Dept.
P.O. Box 1958
Newark, NJ 07101-9774 Telephone: (800) 226-0083

Direct Deposit of Dividends

Information on the Direct Deposit service is available from our transfer agent at this address:

The Bank of New York
Shareholder Services Dept.
P.O. Box 11258
Church Street Station
New York, NY 10286-1258
Telephone: (800) 226-0083

Financial and Other Information

PepsiCo's 1999 quarterly earnings releases are expected to be issued the week of April 19, July 19, and October 4, 1999 and January 31, 2000.

Earnings and other financial results, corporate news and other company information are available on PepsiCo's web site: **http://www.pepsico.com**

Copies of PepsiCo's SEC Form 8-K, 10-K and 10-Q reports and quarterly earnings releases are available free of charge. Contact PepsiCo's Manager of Shareholder Relations at (914) 253-3055.

Securities analysts, portfolio managers, representatives of financial institutions and other individuals with questions regarding PepsiCo's performance are invited to contact:

Susan V. Watson
Vice President, Investor Relations
PepsiCo, Inc.
Purchase, NY 10577
Telephone: (914) 253-3035

Independent Auditors

KPMG LLP
345 Park Avenue
New York, NY 10154-0102
Telephone: (212) 758-9700

Design: Eisenman Associates
Printing: L.P. Thebault
Major Photography: Ben Rosenthal
Chairman's Photograph: John Keating
Printed on recycled and recyclable paper.

百事可乐
Tostitos
ROLD GOLD
Cheetos
The Original
Cracker
MIRINDA
Sabritas
Baked Lay's
NATURALLY BAKED
SOUR CREAM & ONION
POTATO CRISPS